IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 60

FEDERAL POWER COMMISSION,
Petitioner

v.

SUNRAY DX OIL COMPANY, *et al.*

No. 61

THE UNITED GAS IMPROVEMENT COMPANY,
Petitioner

v.

SUNRAY DX OIL COMPANY, *et al.*

No. 62

THE BROOKLYN UNION GAS COMPANY, *et al.*
Petitioners

v.

FEDERAL POWER COMMISSION, *et al.*

No. 80

FEDERAL POWER COMMISSION,
Petitioner

v.

STANDARD OIL COMPANY OF TEXAS,
A Division of Chevron Oil Company, *et al.*

No. 97

THE UNITED GAS IMPROVEMENT COMPANY,
Petitioner

v.

SUNRAY DX OIL COMPANY

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENTS SUNRAY DX OIL COMPANY, TEXACO INC., SUN OIL COMPANY, SOHIO PETROLEUM COMPANY, EDWIN L. COX, HUMBLE OIL & REFINING COMPANY, LAMAR HUNT, GULF OIL CORPORATION, GEORGE H. COATES, PATCHIN-WILMOTH INDUSTRIES, INC., UNION PRODUCING COMPANY, AND CLARK FUEL PRODUCING COMPANY

December 13, 1967

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Opinions Below

Each of the captioned cases involves a review of opinions rendered by the Court of Appeals for the Tenth Circuit. In Nos. 60, 61 and 62 (*Sunray DX*), the opinion and dissent-

ing opinion of the Tenth Circuit (I R. 6696-6757) are reported at 370 F. 2d 181; the related Commission Orders, Opinion Nos. 422 and 422-A (I R. 5769-5804, 6031-6038), are reported at 31 FPC 623, 1315. In Nos. 80 and 97 (*Standard*), the *per curiam* opinion of the Tenth Circuit (II R. 6885-6891), is reported at 376 F. 2d 578 and the opinion on rehearing (II R. 6921-6925) is reported at 376 F. 2d 580; the related Commission Orders, Opinion Nos. 501 and 501-A (II R. 6222-6230, 6426-6431), are reported at 36 FPC 309, 962.

Jurisdiction

The judgment of the Court of Appeals in *Sunray DX* was entered on December 9, 1966 (I R. 6758). Timely Petitions for Writs of Certiorari were filed in No. 60 by the Solicitor General on behalf of the Federal Power Commission, in No. 61 by The United Gas Improvement Company and in No. 62 by The Brooklyn Union Gas Company, *et al.*

The judgments of the Court of Appeals in *Standard* were entered on March 27, 1967 (II R. 6892-6902). Timely Petitions for Certiorari were filed in No. 80 on behalf of the Federal Power Commission and in No. 97 by The United Gas Improvement Company.

By order entered October 9, 1967, each of these Petitions was granted and consolidated with Nos. 111, 143, 144 and 231 (I R. 6926-28; II R. 6929-30). The jurisdiction of this Court rests upon 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

Statutes And Regulations Involved

The pertinent provisions of the Natural Gas Act [Sections 7(c) and (e), 52 Stat. 821-833 as amended, 15 U.S.C. 717-717w]; the pertinent Regulations Under the Natural Gas Act, 18 C.F.R. Subchapter E; and the Commission's

Statement of General Policy No. 61-1 (18 CFR § 2.56; 24 FPC 818), are set forth in Appendix A, *infra*, pp. 1a-9a.

Questions Presented

1. Whether there is substantial evidence to support the Federal Power Commission's determination of the "in-line" price, which it attached as a condition to permanent certification of the sales of natural gas involved?

2. Whether the Commission may retroactively order refunds of amounts collected under lawfully issued temporary certificates when, pursuant to legal precedent and its established policies, the Commission determined both at the time of issuance of such certificates and upon subsequent reconsideration that no refund liabilities should be imposed?[1]

Statement

This case involves orders of the Federal Power Commission (Commission), which granted permanent certificates of public convenience and necessity under Section 7 of the Natural Gas Act authorizing sales of natural gas by certain independent producers (Producers).[2] The Commission's authorization was granted subject to a variety of conditions,

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[1] The additional question purportedly reserved for argument by footnote reservation in No. 80 (p. 4, fn. 1) and raised by Question No. 2 in No. 97 concerns the reasonableness of the Commission's exercise of the disputed refund power in its Opinion Nos. 501 and 501-A. In its second decision below (376 F. 2d 578), the Tenth Circuit did not reach this question in view of its prior determination (370 F. 2d 181) that the Commission lacked a retroactive refund power in the circumstances. The Tenth Circuit made clear, however, that if its disposition of the refund power question were ultimately held to be in error, it is ready to consider the many complex questions, both equitable and legal in nature, which have been raised below concerning the propriety of the Commission's exercise of such power.

[2] This brief is being filed by twelve of those producers who have been named respondents in Nos. 60-62, 80 and 97.

two of which are pertinent here. First, it imposed a condition prohibiting the collection of an initial price higher than 16 cents per Mcf from and after the issuance of the permanent certificates. Second, the Commission imposed refund liabilities retroactively upon those Producers who had previously begun the sales in question under temporary certificates, issued without refund conditions, authorizing the collection of prices higher than 16 cents during the period of temporary certification.

The court below held that substantial evidence supported the prospective price condition imposed by the Commission. However, it held that the Commission lacked the power, in the circumstances presented, to impose refund liabilities retroactively upon Producers' collections under these temporary certificates.

Petitioners here, in addition to the Commission (Nos. 60, 80), are four natural gas distribution companies[3] and the Public Service Commission of the State of New York (Nos. 61, 62, 97).[4]

The Commission Proceedings

All of the Producer sales involved are made from fields in Texas Railroad District No. 4[5] under contracts executed during the 1960-62 period subsequent to the issuance of the Commission's *Statement of General Policy No. 61-1,*

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[3] The United Gas Improvement Company, The Brooklyn Union Gas Company, Long Island Lighting Company and Philadelphia Electric Company.

[4] Petitioners in Nos. 61, 62 and 97 will be collectively referred to as Distributors.

[5] The Texas Railroad Commission has divided the various producing areas in the State of Texas into districts for regulatory purposes. Texas District No. 4 is a producing area at the southern tip of Texas, composed of 15 counties.

18 CFR § 2.56, 24 FPC 818 (1960).[6] This *Policy Statement* was designed to implement the area approach to independent producer regulation during the interim period prior to the establishment of just and reasonable rates. The Commission there established maximum acceptable rates for initial prices in new contracts to serve as a guide to it and interested parties in determining whether proposed initial prices should be certificated without a price condition. The initial price level for new contracts in Texas District No. 4 was set at 18 cents per Mcf.[7] The initial prices in Producers' contracts ranged from 15.9 cents to 19.8 cents per Mcf (I R. 5320-21).

Upon the filing of their respective certificate applications,[8] Producers individually sought temporary certification of their proposed sales pursuant to Section 7(e) of the Natural Gas Act. By separate orders, the Commission granted temporary certificates imposing price conditions, where required, to insure that Producers' initial prices did not exceed the *Policy Statement* level. Eight of these orders were conditioned to require the Producer involved to make refunds dependent upon the terms of the permanent certificate ultimately issued (*e.g.,* I R. 5312-13). The remaining temporary certificate orders contained no such refund con-

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[6] The *Policy Statement* was published in the Federal Register on October 5, 1960 (25 F.R. 9578), and was codified in the Code of Federal Regulations (18 CFR § 2.56).

[7] The 18-cent *Policy Statement* rate remained in effect for nearly two years until the Commission issued its *Fifth Amendment to Statement of General Policy No. 61-1* on August 30, 1962, effective that day, announcing a 16-cent initial rate level for new contracts in Texas District No. 4 (28 FPC 441). All of Producers' contracts were executed prior to August 30, 1962 (IR. 5319).

[8] Each of these applications, pursuant to Section 157.25 of the Commission's Regulations (18 CFR § 157.25), included a copy of the related gas sales disclosing the terms upon which the sale was proposed to be made.

dition or any forewarning[9] that the particular price authorized by the Commission was subject to a possible refund liability at a later time (*e.g.*, I R. 4338, 4346-47).[10]

Subsequently, certain of the Distributors[11] requested the Commission either to set aside those of its orders which had granted temporary certificates without refund condition or to modify them by the imposition of refund conditions. Producers opposed this motion. By its order of February 5, 1963, the Commission denied Distributors' motion. Finding that it had authorized these sales "without condition as to refund" and that Producers had acted "in justifiable reliance" upon such authorizations, the Commission refused to place more stringent conditions upon them after having induced Producers to dedicate their gas to the interstate market under the temporary certificates as issued. The Commission held that it would be "contrary to the public interest, as well as inequitable," to so condition these temporary certificates. Equally important, the Commission concluded that the grant of Distributors' motion "would so denature the value of a Commission authorization as to place any reliance upon our actions in this area in serious jeopardy" (I R. 5305-07). Distributors did not seek judicial review of this order or of the temporary certificate orders themselves.

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[9] All of the temporary certificate orders, both conditioned and unconditioned, contained a routine provision indicating that they were issued "without prejudice" to whatever conditions the Commission might prospectively impose upon the permanent certificates ultimately issued.

[10] The Commission's orders granting these temporary certificates are not before the Court for review. It is the Commission's subsequent orders, retroactively imposing refund liabilities, which are at issue here.

[11] Long Island Lighting Company, Philadelphia Electric Company and The United Gas Improvement Company.

On August 30, 1962, the Commission consolidated for hearing Producers' applications for permanent certification of these sales (I R. 4636-40). Therein, the Commission stated that the purpose of the hearing would be to determine the appropriate price at which Producers' sales should be permanently certificated.[12] At the hearing, Producers offered to prove the propriety of their initial contract prices by cost, geological, supply-demand and economic evidence. However, at the urging of Distributors and the Commission's Staff, this evidence was excluded by the Presiding Examiner on the ground that it was not relevant to a price line determination in a producer certificate proceeding (I R. 5085-5107). The Examiner's exclusionary ruling was later affirmed by the Commission (I R. 5781).

With the scope of the hearing thus limited, the Presiding Examiner received the testimony of various Producer witnesses explaining how the Commission's *Policy Statement* had substantially influenced the negotiation of their gas sales contracts. This testimony also showed that, relying upon the *Policy Statement,* Producers had decided to forego additional negotiations with prospective buyers in an effort to obtain either a higher price or an intrastate market for the gas (I R. 415-16, 428-29, 442-43, 483-85, 787-89, 1043-44). This evidence stands unchallenged.

The Presiding Examiner also received in evidence Exhibit No. 16, sponsored by a Commission Staff witness, which analyzed certain provisions of all Texas District No. 4 contracts, dated 1955 and later, which had been permanently or temporarily certificated (I R. 1073-74, 1600-25).

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[12] For gas produced in Texas District No. 4 under contracts executed prior to the issuance of the *Policy Statement* the Commission had previously determined 15 cents per Mcf to be the proper price line for permanent certification, *Skelly Oil Company,* 28 FPC 401, 412 (1962).

Following the hearing and the Examiner's initial decision, the Commission issued its Opinion No. 422 on March 23, 1964 (I R. 5769-5804; 31 FPC 623). First, it concluded that the relevant time period for making its price line determination should be from September 28, 1960, the date of the *Policy Statement*, until August 30, 1962. This was the period during which Producers' contracts had been executed. Second, it considered and weighed the price line evidence sponsored by its Staff and, largely on the basis of it, concluded that the "in-line" price for the contracts in question was 16 cents per Mcf. The Commission also recognized that its affirmance of the Examiner's ruling excluding Producers' proffered cost and financial requirements evidence made it particularly incumbent upon the Commission "to give special consideration to the field price evidence as to shifts in the pricing line". (I R. 5781). Noting further that a major issue in this case is the effect of its *Policy Statement* upon the initial prices in contracts executed thereafter, it found that the issuance of the *Policy Statement* had had the effect of holding down contract prices to the *Policy Statement* level (I R. 5788). Accordingly, the Commission concluded that in fixing the in-line price level it could not disregard its own *Policy Statement* and its "effectiveness as a ceiling on prices in contracts executed after its issuance" (I R. 5789).

In making its price line determination, the Commission found that, unlike any price line determination it had previously made, the record revealed that during the relevant time period there were not substantial volumes of gas moving under permanent certificates in Texas District No. 4. Indeed, the Commission found that it would be manifestly improper to base its price line determination in this case solely upon the "few isolated and inherently nonrepresentative" sales which had been permanently certificated (I

R. 5784). In these circumstances, it concluded that some weight should be accorded to the evidence concerning sales made under temporary certificates. Otherwise, the Commission's price line determination would not be based upon substantial volumes of gas moving in interstate commerce (I R. 5783).

Based upon its "in-line" price determination of 16 cents per Mcf, the Commission issued permanent certificates to Producers conditioned upon the requirement that they charge not more than 16 cents per Mcf thereafter. At the same time, the Commission reopened the question of refund liabilities as to those Producers who had previously begun their sales under temporary certificates which had been "granted without condition as to refund."[13]

While the question of the Commission's power to prescribe refund liabilities retroactively in these circumstances was pending before the court below on review of the Commission's Opinion No. 422, the Commission exercised its claimed refund power in its Opinion No. 501, issued July 27, 1966 (II R. 6223-30).

The Decisions Below

Upon review of Opinion No. 422, the court below concluded that substantial evidence supported the Commission's 16-cent "in-line" determination. However, it held that the Commission could not, in the circumstances of this case, impose refund liabilities retroactively upon those Producers who had collected prices in excess of 16 cents per Mcf under temporary certificates which made no provision for refunds.

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[13] The quoted language is from the Commission's order of February 5, 1963 (I R. 5305). The Commission made no evaluation of the effect of this order when it issued its permanent certificate order on March 23, 1964.

Thereafter, on review of Opinion No. 501 the court below, upon motion for summary disposition filed by Standard Oil Company of Texas, without briefing or argument, reiterated by *per curiam* orders its holding that the Commission could not lawfully order refunds. In so doing, it did not reach the subsidiary questions of whether, assuming *arguendo* the Commission could lawfully order refunds, it had properly exercised any such refund power under the variety of equitable circumstances presented. On rehearing of its summary disposition of Opinion No. 501, the court below stated that if its holding that the Commission lacked a refund power in the circumstances were held to be erroneous, it would then be ready to consider whether the Commission had properly exercised that power (II R. 6921-25).

SUMMARY OF ARGUMENT

I. The Price Line Question

This case presents for review the in-line pricing methods adopted by the Federal Power Commission in implementing this Court's admonition in *CATCO*[13a] that "careful scrutiny" be given the price levels at which producer sales are permanently certificated in interstate commerce. The sales at issue were all executed in the early 1960's from Texas Railroad Commission District No. 4 after the Commission had promulgated its *Statement of General Policy No. 61-1 (Policy Statement)* providing guidelines for the interim period of initial rate regulation pending the determination of just and reasonable rates.

In its *Skelly* decision, 28 FPC 401 (1962), the Commission previously established a 15¢ per Mcf in-line price for this same FPC pricing area for contracts executed in the late 1950's. The instant proceeding was convened to examine conditions prevailing in the 1960's to determine if a revision

[13a] *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378 (1959).

in the earlier 15¢ in-line price was required. Based upon the evidence adduced, the Commission found that current conditions in the industry pointed to an in-line price of 16¢ per Mcf. Distributors' position, rejected by the court below, is that the Commission abused its discretion in considering evidence reflective of current conditions in the industry and in failing to mechanically adopt its earlier 15¢ in-line price. This position is without legal or evidentiary support and in conflict with the statutory standard of "present or future public convenience and necessity."

In its development and application of the in-line pricing methodology, the Commission has consistently, with the approval of the courts, taken current conditions into consideration. *United Gas Improvement Co.* v. *Federal Power Commission,* 283 F. 2d 817 at 824 (9th Cir. 1960); *Sohio Petroleum Co.* v. *Federal Power Commission,* 298 F. 2d 465 at 467 (10th Cir. 1961); *Continental Oil Co., et al.* v. *Federal Power Commission,* 378 F. 2d 510, 524 (5th Cir. 1967). Distributors improperly seek to defeat the "current conditions" standard by contending the Commission's price line determination must be based solely upon contemporaneously issued permanent certificates. By contesting all certificate applications at initial prices higher than their predetermined acceptable level of 15¢, Distributors have blocked the issuance of any permanent certificates above such level. They now seek to limit the Commission's price line determination here to a consideration of the isolated number of inherently nonrepresentative sales which have been permanently certificated at or below 15¢. The Commission correctly rejected such an approach finding it would lead to a price freeze at levels having no current relevance and determined solely by the "unreviewable fiat" of Distributors.

In establishing its 16¢ per Mcf in-line price for the post-*Policy Statement* period of the 1960's, the Commission correctly considered not only price levels under contempo-

raneously issued permanent certificates, but also gave some weight to the price levels approved for the substantial volumes of gas moving under contemporaneous temporary certificates. Consideration was also given to the applicable *Policy Statement* price level for Texas District No. 4. Each of the relevant factors was carefully evaluated in light of the Commission's expertise developed in the handling of thousands of producer certificate applications. In making an in-line price determination, the Commission has consistently given some measure of weight to price levels approved under temporary certificates as a reflection of current conditions and this procedure has been judicially approved. See, *e.g.*, *Texaco Seaboard Inc.*, 29 FPC 953, 598 (1963); *The Ohio Oil Company*, 27 FPC 551, 553 (1962); *Union Texas Petroleum*, 32 FPC 254, 262 (1964); *Public Service Commission of New York* v. *FPC*, 329 F.2d 242, 245, (D.C. Cir. 1964). The courts have also approved the Commission's consideration of its *Policy Statement* price levels in making initial price determinations. *Public Service Commission* v. *FPC*, *supra* at p. 247; *J. M. Huber Corporation* v. *FPC*, 294 F. 2d 568 (3rd Cir. 1961). The Commission's expertise and informed judgment in evaluating the various types of evidence and balancing conflicting considerations is entitled to considerable respect and deference in a proceeding of this nature. *People of the State of California* v. *Federal Power Commission*, 353 F. 2d 16, 23 (9th Cir. 1965).

The factual findings made by the Commission are supported by substantial evidence and require the establishment of an in-line price no less than 16¢. The Commission specifically found the weighted average price for relevant sales to be in excess of 17.176¢ per Mcf (I R. 5786). It further found that "* * * the sales at prices of 16 cents per Mcf or above account for fully 82 percent of the gas presently moving in interstate commerce under contracts executed in

the time period here under consideration" (I R. 5786). In light of this and other considerations it therefore adopted a 16¢ price line which it found to be "* * * the *lowest* price at which substantial volumes of new gas were sold in interstate commerce in the area during the period in question * * *" (I R. 5789). On the other hand, Distributors adduced no evidence in support of their contention that the Commission's previously determined 15¢ in-line price should be frozen for an indefinite period into the future. Indeed, the record evidence relied upon by the Commission clearly indicated that its earlier price line was no longer relevant in light of changed conditions in the industry.

The lower court's approval of the Commission's revised 16¢ price line should be affirmed.

II. The Refund Question[14]

Producers dedicated their gas to interstate commerce at prices at or below the Commission's *Policy Statement* level under temporary certificates which contained no forewarning that the authorized prices were subject to the possibility of later refund liabilities. Despite its repeated assurances that the authorized prices were firm prices upon which Producers could justifiably rely, the Commission nevertheless imposed retroactive refund liabilities in the guise of a refund condition attached to the permanent certificates issued years later. The court below carefully analyzed the circumstances in which the Commission had granted the temporary certificates as well as the terms of the temporary certificate orders themselves. On the basis of this analysis, the court below held that the Commission could not retro-

[14] The refund question arises only as a result of the decisions below of the United States Court of Appeals for the Tenth Circuit. The Commission and Distributors, petitioners in Nos. 60-62, 80 and 97, raise this question in that context.

actively alter the terms of the temporary certificates and order refunds of amounts which it had previously authorized to be collected thereunder.

Even at the time of its permanent certificate order, issued in March, 1964, the Commission found that these temporary certificate orders had made no provision for refunds (I R. 5791). This finding was in full accord with the Commission's clearly articulated policy that the initial prices collected under these temporary certificates were subject only to prospective modification, if required, at the time of permanent certification. In striking contrast, the present position of the Commission is that these temporary certificate orders were subject to retroactive modification without notice from their inception.

Consequently, an understanding of the rights conferred by these temporary certificate orders is of critical importance. During the administrative proceeding below, Producers applied, on an individual basis, for temporary certificates authorizing the initiation of sales of natural gas produced in Texas District No. 4 under contracts executed subsequent to the Commission's *Statement of General Policy No. 61-1* (24 FPC 818). This *Policy Statement* established initial price standards for various producing areas and was designed to serve as a guide to the Commission and interested parties for certification purposes. While establishing an initial price level of 18 cents per Mcf for Texas District No. 4, the Commission announced to the industry that it would certificate new sales of gas from that area at that level without price condition. In its *Policy Statement*, and thereafter in this case, the Commission made clear that the price standards so established were designed to establish a salutary price stability which balanced the interests of producers and consumers alike

and gave recognition to the needs for certainty of natural gas companies and the public generally (I R. 5307).

The temporary certificates granted to Producers in this case were an implementation of the *Policy Statement.* In each instance, the Producer was authorized to initiate his proposed sale at the initial price in the contract only if it conformed to the *Policy Statement* level of 18 cents. Most of the initial contract prices were below that level. It is clear that these temporary certificates were the product of the Commission's mature consideration. Thus, when Distributors requested the imposition of refund conditions upon the temporary certificates, the Commission refused to do so in a definitive order which explained the many reasons for its refusal (I R. 5305-07). Distributors have never challenged this order, or the temporary certificate orders themselves, all of which are judicially reviewable.

It is not disputed that the Commission possesses broad power to attach reasonable conditions to producer certificates of public convenience and necessity, both temporary and permanent, *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378 (1959); *Federal Power Commission* v. *H. L. Hunt,* 376 U.S. 515 (1964). But it is only reasonable to conclude that, armed with such broad power, the Commission must exercise it at the time of authorization so as to permit the producer to know the terms and conditions under which he is dedicating his gas reserves to interstate commerce, *Sunray Mid-Continent Oil Company* v. *Federal Power Commission,* 270 F. 2d 404 (10th Cir. 1959). The Commission itself has recognized the need for such certainty in this case. Moreover, the clear implication of the Court's recent decision in *Federal Power Commission* v. *H. L. Hunt, supra,* confirms the proposition that if the Commission finds it in the public interest to condition its certificate orders, it should do so when the authorization

is granted. Otherwise, as the Commission concluded in its order of February 5, 1963 in this case, the retroactive imposition of conditions upon certificate authorizations "would so denature the value of a Commission authorization as to place any reliance upon our actions in this area in serious jeopardy" (I R. 5307).

The court below correctly found that price certainty and stability provide important benefits to consumers in assuring the maintenance of an adequate supply of gas:

> "* * * A repricing of the gas, without warning, cannot help but have a severe impact on the operations of the producers. We will not speculate on the effect of such repricing on their exploration and development activities. The benefits derived from such costly activities may or may not be of greater value, from the public standpoint, than the few dollars recovered by the home consumer. Perhaps he would rather have an assured supply for his expensive appliances than a modest refund. * * *" (I R. 6735-6); 370 F. 2d at 192-93)

The Commission's imposition of a retroactive refund condition upon Producers' sales made under valid temporary certificate orders is plainly unlawful for various reasons. Its effect, in any event, is to apply on a retroactive basis a change in a well-reasoned Commission policy designed to create price stability in the natural gas industry. The *post hoc* rationalizations by which the Commission now seeks to justify its action here are equally unsound. Before the court below, it went so far as to contend that the temporary certificates in question do, in fact, contain a refund condition by virtue of certain language which is routinely inserted in all temporary certificates which it issues. The court below properly rejected this contention, noting that the Commission had previously refused to interpret this language as a refund condition.

Finally, while conceding that the temporary certificates in question do not provide for refunds, the Commission argues that its retroactive imposition of refund liabilities may be justified as the undoing of "what [was] wrongfully done by virtue of its order," citing *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223, 229 (1965). This argument is totally inapposite. In contrast to the judicially invalidated certificates in *Callery,* Producers' sales were made pursuant to and in reliance upon valid temporary certificate orders. These orders, as well as the Commission's order of February 5, 1963 herein, were judicially reviewable and, in the absence of review, became binding upon all, including the Commission. To suggest now that these orders, and Producers' reliance upon them, were "wrongful" merely highlights the Commission's attempt to apply retroactively a change in Commission policy.

ARGUMENT

I. THE COMMISSION'S 16¢ IN-LINE PRICE DETERMINATION IS FULLY SUPPORTED BY THE CONTROLLING LEGAL PRECEDENTS AND SUBSTANTIAL EVIDENCE.

A. The Commission Properly Considered Current Conditions

The basic principles underlying the issuance of producer certificates under Section 7 of the Natural Gas Act were established by this Court in *CATCO.*[15] There the Commission was directed to give a "most careful scrutiny" to producer initial price proposals while also evaluating "all factors bearing on the public interest." The imposition of certificate conditions under Section 7(e) was approved where the proposed price is "out of line" or "might result

[15] *Atlantic Refining Co. et al.* v. *Public Service Commission,* 360 U.S. 378 (1959).

in a triggering of general price rises." The opinion in *CATCO*, however, did not define the "line" or fix precise standards by which a determination may be made of whether a price is "in line" or "out of line."

On *CATCO* remand, the Commission first developed the "in-line" methodology for certificating producer sales. *Continental Oil Co., et al.*, 27 FPC 96 (1962). There the Commission concluded that the appropriate price line was to be determined as of the *date of* the sales contract involved, based upon *"comparable"* existing producer prices under which *"substantial* amounts of natural gas were moving in interstate commerce" (27 FPC at 100).

The Commission's purpose in convening the instant proceeding was to determine the appropriate initial price for issuing permanent certificates applicable to producer sales from Texas District No. 4 under contracts executed subsequent to the issuance of its *Statement of General Policy* on September 28, 1960.[16] The Commission previously had reviewed evidence of the in-line price for the above pricing area during the period of the late 1950's and based upon conditions existing at that time issued permanent certificates at initial prices up to 15¢ per Mcf (thousand cubic feet).[17] Recognizing that changing industry conditions might warrant some adjustment in its earlier in-line determination, the Commission instituted the instant proceed-

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[16] For additional discussion of Commission's *Policy Statement* see pp. 29-31, *supra*.

[17] *Skelly Oil Co.*, 28 FPC 401 (1962), *aff'd* as to price line; *Public Service Commission of New York* v. *Federal Power Commission*, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied sub nom.; Prado Oil & Gas Co.* v. *Federal Power Commission*, 377 U.S. 963 (1964).

ing to examine the conditions prevailing in the 1960's.[18] In its order convening this proceeding the Commission stated (I R. 4638):

> "In such a hearing all of the applicants will have an opportunity to show whether the appropriate price at which they should be permanently certificated should be limited to the 15 cent per Mcf price which we found to be the in-line price as of September 28, 1960, the 16 cent per Mcf price which is being adopted as the future area ceiling price for this area, or the 18 cent per Mcf price established [by the *Policy Statement*] on September 28, 1960."

It is axiomatic that *present* conditions in the natural gas industry are the touchstone of "present or future public convenience and necessity," the statutory standard which the Commission is charged to apply by Section 7(e) of the Natural Gas Act. *City of Pittsburgh* v. *FPC*, 237 F. 2d 741, 752 (D. C. Cir., 1956); *American Airlines, Inc.* v. *CAB*, 192 F. 2d 417, 420-21 (D. C. Cir., 1951).

In requesting reversal of the lower court's affirmance of the Commission's 16¢ per Mcf in-line price Distributors are necessarily asking this Court to hold that the Commission should ignore current conditions in the industry and mechanically apply its in-line price determination for an earlier period. Specifically, they contend the Commission should have applied the 15¢ per Mcf price line found appropriate for the 1950's during the entire period (which may run over a decade) prior to the establishment of a "just and reasonable" area rate for Texas District No. 4. Such a price freeze in the face of changed conditions would be

[18] In its *CATCO* remand the Commission expressly recognized that modifications to its in-line methodology might be required during latter periods following the issuance in 1960 of its *Statement of General Policy* establishing guideline area price levels (27 FPC at 100).

contrary to the public interest and inconsistent with the entire philosophy of initial pricing. As the Commission stated in its order issuing permanent certificates in the instant case:

> "A rule of law that would deprive producers of any opportunity to show that the initial prices in the 1950's did not suffice for the 1960's or, conversely, that would deprive consumer groups of an opportunity to show a decline in the price level, is not fair to the producers or in the long term interest of consumers. Nor is such a rule even suggested by the decisions of the courts... It ['holding the line'] does not mean, irrespective of evidence to the contrary, an absolute price freeze is to be imposed until some future date when area proceedings ultimately establish just and reasonable rates." (I R. 5785)

The courts have recognized that a price line determination by the Commission should reflect current conditions and must change when such conditions change. Before the Ninth Circuit, The United Gas Improvement Company, one of the petitioners here, argued in effect that current conditions need not be considered.[19] The Court of Appeals emphatically disagreed:

> "As previously indicated, *the price line is intended to reflect current conditions in the industry*. Therefore, comparable prices upon which it is based must be prices under which a substantial amount of natural gas presently moves in interstate commerce. *The limitation urged by UGI could well defeat this objective* by restricting the comparison to a small number of contracts under which little gas moves today. *It could, in fact, require a rollback to prices having no current relevancy*" (283 F. 2d at 824).[20]

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[19] *United Gas Improvement Co.* v. *FPC*, 283 F. 2d 817, *cert. denied sub nom., California Co.* v. *United Gas Improvement Company*, 365 U.S. 881 (1961).

[20] All emphasis herein supplied unless otherwise indicated.

Other Circuits have uniformly upheld the Commission's attempt in Section 7 certificate proceedings to look to the *present* — rather than the *past* — in applying the statutory standard of present or future public convenience and necessity. In approving a revision of the in-line price to reflect changed conditions during the post-*Policy Statement* period, the Fifth Circuit in *Continental Oil Co., et al.* v. *Federal Power Commission, et al.*, 378 F. 2d 510 (1967),[21] quoted with approval the holding of the court below:

> ". . . The apparently inevitable time lag between certification and establishment of a just and reasonable rate affects the mutability of an established in-line price.
>
> "The Commission has recognized that the in-line price *must reflect current conditions.* The Courts of Appeals have agreed. Further support is found in the *Callery* decision where the Supreme Court referred to 'other contemporaneous certificates' and "prices higher other existing levels . . . ' " (378 F. 2d at 524).

In *Sohio Petroleum Co.* v. *Federal Power Commission,* 298 F. 2d 465 (10th Cir. 1961), the court stated at page 467:

> "The purpose of establishing an in-line price is of course the stability accorded producer, buyer, and the public in balance with the respective interests of each. Permanence is dependent upon the maintenance of such balance and the duty to guard, review, and, *if necessary, change the in-line price* rests with the Commission."

In its prior decisions, the District of Columbia Circuit has also recognized the time factor in determining the in-line price. In *Atlantic Refining Company* v. *Federal Power Commission,*[22] the Court stated:

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[21] Petitions for certiorari pending in Nos. 504, 520, 526, and 628 this Term.

[22] 316 F.2d 677 (D.C. Cir. 1963).

> "As used in *CATCO*, the line means the price at which similar sales, not suspect, were made under similar circumstances from the same area *about the same time.*"[23]

Distributors ignore the fact that the Commission's consideration of contemporary conditions and contemporary sales has in some instances resulted in a lower price line being established than would have been the case if reliance had been placed upon past periods. Thus the Commission found with respect to the 15¢ price line originally established for Texas District No. 4:

> "This line should be determined as of the time the contracts were made,[13] so that we should properly put greater emphasis on the calendar years 1958, 1959, and 1960." (Footnote omitted) *Skelly Oil Co., et al.*, Docket Nos. G-18638, *et al.*, 28 FPC 401 at 408 (1962).

The Commission's rejection of higher price levels prevailing in *prior* years was specifically approved on appeal by the District of Columbia Circuit:

> "The producer-petitioners make special objection to the Commission's refusal to rely upon a number of sales at 16 to 17 cents made in 1955 and 1956 to the Coastal Transmission Corp. *Since the Coastal sales were made before the 1958 to 1960 period when the contracts in the present cases were entered* into and since the majority of the subsequent sales in Texas Railroad District No. 4 were at less than 15 cents, *the Commission could reasonably determine as it did that the Coastal sales did not establish a valid line of 16 to 17 cents for that area during the 1958 to 1960 period." Public Service Commission of New York* v. *FPC*, 329 F. 2d 242, 246, 1964)

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[23] *Id.*, at page 680. In this case the District of Columbia Circuit affirmed the Commission's decision that the price line in North Louisiana had changed over a 17-month period from 16.5 cents to 17.0 cents, as of May 1, 1959, based upon consideration of contract prices and temporarily-certificated prices.

In other in-line proceedings, the Commission has been equally careful to base its price line upon evidence relating to the period contemporaneous with the contracts at issue. In Opinion No. 351, *Continental Oil Co.*, 27 FPC 96 at 100 (1962), the Commission determined the in-line price pursuant to this Court's directives in *CATCO* and stated that:

> "... we think that the question of 'in-lineness' should be determined as of 1956. It was then that the parties agreed on a price."

In Opinion No. 412, *Hassie Hunt Trust (Operator), et al.*, 30 FPC 1438 at 1442 (1963), the Commission held:

> "It is important to recognize that the key element in our in-line determination is the time at which the contract in issue was executed. *We cannot assume that the evidence upon which we govern an in-line determination for contracts in the late 1950's can automatically be applied to contracts executed in the 1960's.* On the contrary it would seem clear that the evidence must relate to a period reasonably contemporaneous with the contracts in issue."

Distributors' challenge to all initial prices proposed at levels higher than the Commission's original 15¢ in-line determinations for the late 1950's disregards the requirement that a proper price line determination must be based upon the current conditions prevailing in the area at the time the contracts in question were executed. Consonant with Distributors' approach, the Examiner based his recommended price line solely upon permanently certificated prices which represented only 1.39% of the volumes for all sales shown (I R. 5784). Such an approach is patently in conflict with the standard approved by this Court in *Callery*[24] where the "in-line" price was held to be the level

[24] *United Gas Improvement Company* v. *Callery Properties, Inc.*, 382 U.S. 223, 227 (1965).

at which "*substantial* amounts of gas have been certificated to enter the market . . . "

No evidentiary nor legal support exists for Distributors' position that the Commission must, as a matter of law, mechanically freeze its in-line levels for the 1950's regardless of whether the circumstances which led to the adoption of such initial price levels continue to exist. When dealing with a growing and viable industry, the Commission must be permitted, if not affirmatively *required* to consider changes in industry conditions. Otherwise, it cannot act in conformity with the present or future public convenience and necessity standard of the Act.

B. The Commission's 16 Cent In-Line Price Is Supported By Substantial Evidence

In reaching its 16¢ per Mcf in-line price determination, the Commission considered three catagories of evidence: (1) price levels under contemporaneously issued permanent certificates, (2) price trends under contemporaneously issued temporary certificates and (3) the applicable *Policy Statement* price level. This evidence evaluated by the Commission in light of an informed judgment and expertise developed in the handling of thousands of producer certificate applications was then the basis for the Commission's findings (I R. 5789). Distributors challenge these findings as being not supported by substantial evidence. However, the legal presumption in favor of such administrative findings is well established. *Consolo* v. *Federal Maritime Commission*, 383 U.S. 607 (1966); *Illinois Central Railroad Company* v. *Norfolk & Western Railway Company*, 385 U.S. 57 (1966).

1. *Permanent Certificates* — The Commission turned first to the initial prices approved in permanent certificates

covering contracts executed during the relevant pricing period. All parties agree that this was relevant evidence. The Distributors say that it is the *only* evidence which the Commission can consider. The Commission disagreed, recognizing that such an approach due to the intervention and protest policies of Distributors would completely foreclose evaluation of current conditions in the industry and result in the price line being determined ". . . not upon consideration of a hearing record, but by the unreviewable fiat of the interveners" (I R. 5783).

An examination of the workings of Distributors' "suspect price doctrine"[25] on a chronological, step-by-step basis quickly discloses that their position automatically results in a freezing of the price line at whatever level they select.

Step 1. Distributors decide that the in-line price for a certain area is to be 15¢ per Mcf.

Step 2. When any producer in that area applies for a permanent certificate, if the initial contract price is higher than 15¢ per Mcf, the Distributor intervenes and protests.

Step 3. As a result of their unilateral action, Distributors then contend that the proposed price is "suspect" and therefore ineligible for consideration in making an in-line determination.

Step 4. Distributors continue to intervene in all producer applications in which the initial contract price is higher than 15¢ per Mcf. This effectively blocks the Commission from granting any permanent certificates at initial prices higher than Distributors' predetermined level.

[25] This doctrine holds that it is an abuse of discretion for the Commission in establishing a price line to rely upon prices other than those "which have previously received permanent certification following hearing and which are not suspect because they are under judicial review or otherwise" (Pet. in No. 62, p. 12).

If the only relevant evidence on which the Commission can base its in-line price determination is confined to permanent certificates which Distributors have not challenged, then the only purpose of the Section 7 hearing is for the Commission to "find" what has been inevitable from the start, *i.e.*, the only "non-suspect" permanent certificates issued during the relevant time period are at the Distributors' pre-determined price level of 15¢ per Mcf or below. The approval of such a procedure would render the hearing required by Section 7 of the Act meaningless. It would completely foreclose the Commission from making adjustments to reflect current conditions in the industry. Moreover, it would deprive the Commission, as in this case, from basing its pricing determination upon substantial volumes of gas moving in interstate commerce.

Although advised by the Commission's order instituting these proceedings that the basic issue was whether the initial price should be 15¢, 16¢, or 18¢ (I R. 4638), Distributors failed to introduce any evidence in rebuttal to the presentations made by the producer applicants and the Commission Staff. The 15¢ "non-suspect" prices upon which Distributors rely were found by the Commission to be ". . . isolated and inherently nonrepresentative . . ." (I R. 5784). The Commission also found that:

> ". . . unlike any previous 'in-line' determination rendered by this Commission, the record before us contains neither substantial numbers of relevant permanently certificated contracts or evidence of substantial volumes of gas moving under permanent certificates" (I R. 5782-5783).

This finding is unchallenged. Clearly consideration of other types of evidence was required to determine if current conditions dictated a revision in the Commission previously approved price line.

2. *Temporary Certificates* — In addition to the isolated and non-representative permanent certificates, the Commission also considered initial prices approved during the relevant time period under temporary certificates. In determining to give consideration to temporary certificates, the Commission expressly rejected Distributors' contention that sales under temporary certificates fell within the "suspect price" doctrine (I R. 5783). Distributors object to the Commission's consideration of temporary certificate price levels and characterize such levels as reflecting merely ". . . current, essentially unregulated market levels . . ." (Pet. for Cert., No. 62, p. 12). By use of such labels, Distributors seek to intimate that the Commission exercised no discretion in the issuance of temporary certificates with respect to the price authorized or the other conditions contained therein. They further allege that such certificates were issued *ex parte* and under undefined procedures which provided Distributors no notice or opportunity to contest. These characterizations are totally false.

Each temporary certificate is issued only after Commission review pursuant to well-established policies regarding *inter alia,* (1) initial price levels, (2) rate increase moratorium, and (3) refunds. Specific conditions with respect to the above items are frequently imposed.[26] Where the price proposed by the producer for a temporary authorization gas sale was in excess of the initial price level set forth in its *Policy Statement* as currently revised, the Commission imposed a price condition down to the applicable price level.

Additionally, the provisions of Section 157.28 of the Regulations Under the Natural Gas Act clearly defined the procedures under which these temporary certificates were

[26] The mature consideration given by the Commission to applications for temporary certificates is discussed in greater detail at pp. 38-43, *infra*.

issued. Each of the Producers in the instant case fully complied with these procedures by filing with the Commission the appropriate certificate application and rate schedule intended to be effective for the sale. All of these filings were available to the Distributors for examination in the Commission's Public Reference Room. Similarly, the temporary certificate issued by the Commission with respect to the Producers' initiation of such sale was also placed on file by the Commission in its Public Reference Room (I R. 5305);[27] hence, there was no secrecy involved in the temporary authorization of these sales. The Distributors, then, as now, had ample notice of, and opportunity to object to, these sales prior to their commencement Moreover, since the courts have uniformly held that temporary certificates issued by the Commission are reviewable [redacted] orders, any party opposed to the commencement of such sale had open to him an adequate avenue of protest.[28] Price levels approved under temporary certificates in accordance with clearly defined and well-established policies providing for notice to interested parties of an opportunity for judicial review cannot be fairly classified as "essentially unregulated."

Distributors also imply that the Commission deviated from its past practices in giving consideration to temporary certificates. This is erroneous. In its *Skelly* decision, the Commission gave a "limited degree of consideration" to the temporary certificates issued during the relevant time

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[27] Counsel have been informed that, since early 1960, copies of all temporary certificates have been placed in a special book in the Commission's Public Reference Room for easy access by interested members of the public. This is supplementary to the Commission's Rules of Practice and Procedure providing for public access to all filings and Commission orders relating to such filings. See 18 CFR 1.36(c).

[28] *Pure Oil Co.* v. *Federal Power Commission*, 292 F.2d 350 (7th Cir. 1961); *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 270 F.2d 404 (10th Cir. 1959).

period (28 FPC at 1068). In the *Skelly* appeal the District of Columbia Circuit noted with approval that the Commission "gave less consideration to prices allowed under temporary certificates than under permanent certificates. . ." (329 F. 2d at 245-246). See also *Texaco Seaboard Inc.*, 29 FPC 593 at 598; *The Ohio Oil Company*, 27 FPC 551 at 553; *Union Texas Petroleum*, 32 FPC 254 at 262. It should also be noted that, unlike *any* of the temporary certificates issued and considered by the Commission (with the court's approval) in the *Skelly* case, *all* the temporaries reviewed by the Commission in the instant proceeding were issued subsequent to the Commission's issuance of its *Statement of General Policy* and in accordance with the specific guidelines and standards set forth therein.

In the instant case, the Commission gave limited weight to the price levels under contemporaneously issued temporary certificates. An in-line price of only 16¢ per Mcf was established when the weighted average contract price for all sales under permanent and temporary certificates issued during the relevant time period was 17.2¢ per Mcf (I R. 5787). In determining to give some consideration to prices under temporary certificates, however, the Commission found:

> "*Refusal to consider the temporarily authorized prices,* in the circumstances of this proceeding, and reliance only on the few permanently certificated prices *can only result in a complete stagnation of prices at the 'in-line' level* initially determined for this District, a level *based on prices being paid for gas under contracts drawn up long before these contracts were executed*" (I R. 5787).

3. *Policy Statement*—Distributors also object to the Commission's consideration of the price levels established in its *Statement of General Policy* and the *Fifth Amendment* thereto. These levels reflect the Commission's expertise

acquired after working with producer matters for many years, are periodically revised, and based upon careful consideration of voluminous factual data:

> "In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas" (24 FPC at 819).

The Commission's *Policy Statement* price levels have provided an effective regulatory tool during the interim period prior to the establishment of just and reasonable rates. Its implications were thoroughly explored and approved by the Court of Appeals for the District of Columbia Circuit in *State of Wisconsin, et al.* v. *Federal Power Commission,* 303 F. 2d 380 at 387 (1961), *aff'd* 373 U.S. 294 (1963). Giving some measure of weight to the *Policy Statement* price levels in an in-line proceeding also has been approved by the District of Columbia Circuit in *PSC of New York* v. *Federal Power Commission,* 329 F. 2d 242, 247 (1964), where the court held, "The Commission could not have ignored altogether its own Policy Statement. . . ." The Third Circuit similarly held in *J. M. Huber Corp.* v. *FPC,* 294 F. 2d 568, 570 (3rd Cir. 1961).

The record establishes that *Policy Statement* guideline levels affected industry contracting practices during the relevent pricing period. In reliance upon such levels, many Producers decided to forego intrastate sales opportunities.[28a] Others voluntarily accepted lower contract prices in order

[28a] For example, the evidence shows that Lamar Hunt in reliance upon the 18¢ *Policy Statement* price accepted a proffered unconditioned temporary certificate authorizing a 16.5¢ interstate sale in lieu of a comparable intrastate sale (I R. 483-85).

to avoid the cost and uncertainty of extended contested litigation (I R. 416, 428, 442-44). In determining to give some measure of weight to its *Policy Statement* price levels, however, the Commission also recognized that such unilaterally determined prices could not deprive any party of substantive rights and were at all times subject to challenge in a contested hearing. This is reflected by the Commission's establishment of a 16¢ in-line price for a time period in which the applicable *Policy Statement* guideline ceiling was 18¢. Distributors were given a full and fair opportunity to present evidence challenging the *Policy Statement* price levels, but failed to do so. Accordingly, there is no record support for the Distributors' position that the Commission abused its discretion in giving consideration to its *Policy Statement*.

4. *Additional Economic Evidence Proffered by Producers*—Part of the record evidence tendered for the Commission's consideration was certain geological, supply-demand, economic and financial requirements testimony (less than 400 pages in length, including exhibits) which Producers proffered in support of their proposed initial prices. This evidence was stricken in its entirety by the Presiding Examiner.[28b] The Commission upheld the action of the Presiding Examiner in this respect and the court below affirmed the Commission noting, however, that:

> "We do not say that economic and geologic evidence is never admissible in a §7 proceeding. This may depend on varying circumstances. All we say is that in the posture of this case the Commission did not abuse its discretion by rejecting the evidence[14]" (Footnote omitted, I R. 6710).

The Commission's opinion makes clear that the exclusion of this evidence was premised on the assumption that the record contained sufficient *other* evidence, including tempo-

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[28b] This evidence is summarized in Appendix B.

rary certificate and *Policy Statement* price levels, to determine a revised initial price line in light of current conditions in the industry. Thus, the Commission states:

> "We note, however, that *the refusal to permit the producers to attempt to show cost and other economic justification* for a higher price line over that prevailing in an earlier period, administratively essential if we are to achieve 'in-line' determinations prior to the resolution of area rate proceedings, *makes it encumbent on the Commission to give special consideration to the field price evidence as to shifts in the pricing line*" (I R. 5781).

Unless the Commission is permitted to consider evidence in addition to "non-suspect" contemporaneous permanent certificates, it will be placed in a strait jacket by the distributors' intervention and protest policies. If the additional evidence relied upon by the Commission to justify a revision in its price line to reflect changed circumstances is incompetent, the only alternative is a reopening of the record to receive the general economic evidence tendered by the producer applicants.[29]

C. The Evidence Adequately Supports The Commission's Findings

The Commission established a 16¢ per Mcf in-line price which was ". . . the *lowest* price at which substantial volumes of new gas were sold in interstate commerce in the

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[29] In this connection, several Producers have filed a conditional cross-petition currently pending as No. 82, this Term. In the event that this Court should determine that the evidence considered by the Commission was improperly used to determine the price line, the granting of this pending conditional cross-petition would enable the Court to consider, this Term, the full spectrum of the potential evidentiary record available to the Commission in reaching its decision below without the necessity of a separate remand.

area during the period in question . . ." (I R. 5789).[30] While we believe the evidence would have supported an initial price higher than 16¢ per Mcf,[31] the Commission's action shows that substantial weight was given to the Distributors' arguments in support of lower price levels, even to the extent of deviating from its past methodology approved by this Court in *Callery*.

The Commission's in-line technique was defined in its Brief to this Court in *Callery* at page 31 as follows:

> "The evidence was uncontradicted, the specific finding undisputed, and the only question is whether the Commission acted improperly in fixing the in-line price at the *highest level* remaining after eliminating from its consideration the unsupported CATCO prices and similar prices obviously influenced by the Commission's earlier erroneous certification of the CATCO contracts.
>
> "We submit that the Commission's action is supported, if not indeed required, by prior decisions of this Court."

Insofar as any method of determining an in-line price has been sanctioned by the Court, this was the method. This method is also reflected in the following statement in the majority opinion:

> "We believe the Commission can properly conclude under § 7 that adequate protection to the public interest requires as an interim measure that gas not enter the interstate market at prices *higher than existing levels*" (382 U.S. at 227).

The findings made by the Commission from the evidence clearly demonstrates that the 16¢ per Mcf level it estab-

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[30] In its initial in-line determination following the *CATCO* remand, the Commission found the proper price line to fall between the highest group of prices and the median price (27 FPC at 485).

[31] See dissenting option of Judge Seth (I R. 6745-6757).

lished was definitely not excessive but rather was the "*lowest* reasonable level" permitted by the evidence before it. The Commision specifically found that:

(1) The weighted average contract price for the relevant sales was in excess of 17.176¢ per Mcf (I R. 5786).

(2) Seventy-one percent of relevant volumes was sold at initial rates of 17¢ and above (I R. [redacted] 5786).

(3) ". . . [T]he sales at prices of 16 cents per Mcf and above account for fully 82 percent of the gas presently moving in interstate commerce under contracts executed in the time period here under consideration" (I R. 5786).

(4) ". . . there is evidence that points in the direction of a higher price" (I R. 5789).

(5) ". . . our decision herein draws the line substantially below the average going price for gas in the area" (I R. 5790).

(6) ". . . the 16-cent determination herein thus not only preserves, but actually rolls back, the initially considered price line for the period in issue" (I R. 5790).

(7) A price level of 18¢ would not have an adverse effect on the existing pricing structure in this area (I R. 5791).

In reaching its 16¢ per Mcf in-line price determination, the Commission exercised its "informed judgment and utilization of the expertise developed in the handling of thousands of producer certificate applications" (I R. 5789). A balancing of the many conflicting policy considerations and principles applicable to the formulation of an in-line price consistent with current conditions in the industry must to a certain extent rest upon the Commission's expertise. This fact was cogently recognized by the Ninth Circuit Court of Appeals in *People of the State of California* v. *Federal*

Power Commission, 353 F. 2d 16 at 23 (1965), wherein the court stated:

> "We think, then, that in view of the many 'in-line pricing' cases that the Commission has decided, and of the attitude that it has shown in deciding them, we owe it the same deference to its expertise the courts generally owe to the specialized boards and commissions created by the Congress to deal with complex and difficult problems in the field of economic regulation."

Quoting with approval the above opinion of the Ninth Circuit, the lower court also recognized the important role of agency expertise under the circumstances presented in the instant case (I R. 6728). In a subsequent opinion the Tenth Circuit has also succinctly stated the guiding principles in an in-line proceeding, *Pan American Petroleum Corp., et al.* v. *FPC, et al.*, 376 F. 2d 161 at 168-169, petition for cert. pending in Nos. 227 *et al.*:

> "The general purpose of the Act is to protect the consumer, but section 7 proceedings, as well as other proceedings in the administration of the Act, must consider an attempt to obtain a balance between the interests of consumer, producer and all others whose interests fall between. *The task is difficult, but experience has gradually attached more than lip-service significance to administrative expertise.* Temporary certificates are now conditioned rather than perfunctorily granted. Contract prices have made some adjustment in view of the inescapable captured market of regulation. The establishment of guidelines is a considered administrative function. Settlement agreements are a recognized and judicially encouraged instrument to provide both a semblance of price stability to producers and to mitigate against delay to the consumer interests. [Citations omitted] We consider each of these procedural and background incidents to have proper evidentiary significance in a section 7 proceeding to be weighed by the Commission against the impact of

Under The Natural Gas Act,[33] Producers requested authorizations to commence deliveries under temporary certificates. The Commission authorized these individual dedications of natural gas to interstate commerce and simultaneously accepted the respective sales contracts as the rate schedules governing these sales. Price conditions were imposed, where appropriate, to insure that the initial prices did not exceed the applicable *Policy Statement* price level.

Eight of the temporary certificates required the Producer to accept as a condition to its grant, the possibility of later refunds. The typical refund condition in those certificates provided that, if the permanently certificated price for the sale were less than the price collected under the temporary certificate, refunds would be required measured by the permanently certificated price or by an express refund floor whichever was higher. However, the refund question presented by this litigation does not concern these eight refund-conditioned temporary certificates.[34]

The refund issue here does concern the temporary certificates issued by the Commission which did not contain any forewarning whatsoever that the price authorized by the Commission would be subject to possible refunds upon permanent certification.[35] It is the Commission's retroactive imposition of refund liabilities upon those sales made

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[33] 18 C.F.R. §157.28(c).

[34] In its Opinion No. 422, the Commission required refunds by those Producers who had accepted a temporary certificate with a refund condition and had sold their gas at a price in excess of the Commission's later "in line" price determination of 16 cents per Mcf (I R. 5791). The lawfulness of this requirement is not questioned here.

[35] In its Opinion No. 422, the Commission described these unconditioned temporary certificates as follows:

"The temporary authorizations issued in the remaining dockets do not provide for refunds in the event the initial public convenience and necessity price is found to be lower than the prices permitted under the authorizations * * *" (I R. 5791).

producing industry requires that the terms and conditions of Commission authorization be known, and thereafter honored, when gas reserves are irrevocably committed to interstate commerce. Otherwise, the substantial expenditures and investments required to bring forth such reserves cannot reasonably be made. In obvious recognition of the need to assure producers that the terms and conditions of certificate authorizations issued in implemention of the *Policy Statement* could be relied upon, the Commission concluded:

> "* * * the price standards established by this statement will aid in effectively applying the provisions of the Act to independent producers on a simple, clear and administratively feasible basis, and in a manner fair to all whose interests are affected by Commission regulation * * *" (24 FPC at 819).

For Texas District No. 4, the *Policy Statement* established an initial price level of 18.0 cents per Mcf for new sales under contracts executed after September 28, 1960 (24 FPC at 820). The contracts accepted by the Commission as rate schedules governing the sales in question were executed after the promulgation of the Commission's *Policy Statement*. It is undisputed that many of the Producers were guided by the *Policy Statement* in deciding to commit their gas reserves to interstate commerce.[38] Moreover, the temporary certificates authorizing these sales without refund condition were issued while the *Policy Statement*

[38] Evidence presented by the Producer applicants at the hearing below concerning permanent certification demonstrates that the Producer sellers were well aware of the *Policy Statement* price as a practical limitation upon their contract negotiations with the pipelines. This evidence also demonstrates that the Producers relied upon the 18¢ *Policy Statement* level as a guide in their contract negotiations (*e.g.*, I R. 415-16, 427-29, 442-43, 1042-44).

price of 18 cents was in effect. There is no question that the Commission itself consciously adhered to its *Policy Statement* in granting these temporary certificates. Moreover, the record shows that Producers relied heavily upon the temporary certificates as issued by giving up specific intrastate markets for their gas.[39]

After the Commission issued these temporary certificate orders, Distributors requested that the Commission either set aside those orders or modify them by the imposition of refund conditions. "This we will not do" held the Commission by its order of February 5, 1963 (I R. 5307; 29 FPC 218, 220).[40] In that order, the Commission held that it had issued the questioned temporary certificates and authorized the collection of prices "without condition as to refund" and that those rates were the lawful rates to be collected "until a prospective price could be determined." It also found that since Producers had commenced deliveries in "justifiable reliance" upon those certificates, as issued, the imposition of the refund conditions sought by Distributors would place the Commission in the "position of having induced producers to dedicate their gas to the market upon

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[39] For example, one of the Producer witnesses testified that the sales contract of his company specifically provided for the sale of the gas involved in intrastate commerce if the Commission required a reduction of the 16.5 cent initial price (I R. 483-85). However, the Commission issued a temporary certificate without price condition.

[40] Producers do not concede that the Commission possessed the power to unsettle the temporary certificates previously issued by imposing upon them a new and onerous prospective condition at that time. Nevertheless, the reasons given by the Commission in denying Distributors' motion demonstrate that its refusal to impose refunds upon the temporary certificates was founded upon a mature consideration made in the light of the circumstances of this case and the purpose of its *Policy Statement* (I R. 5305-07).

one set of conditions, and then imposing more stringent conditions upon them" (I R. 5305-5307).

However, quite independently of the foregoing reasons, the Commission also justified its unconditioned temporary certificate orders by reference to its *Policy Statement*, stating:

> " * * * in granting temporary authorizations at our area ceiling prices for producers to sell gas, pending the conclusion of the statutory hearing on the permanent certificate, we have balanced the competing interests of producers and consumers (as well as given full consideration to the needs for certainty of the natural gas companies and the public generally) by providing that while the temporarily certificated price is not subject to refund, the price during this interim period cannot exceed our ceiling price and the producers may not file for any higher price authorized by their contract pending issuance of the permanent certificate" (I R. 5307).

It further stated that its *Policy Statement* ceiling prices represented its judgment of the price levels which would enable it

> "* * * to hold the line on new sales in the area at a level consistent with the public interest and, at the same time, to enable producers to obtain authorizations which provide them a reasonable basis for proceeding with their operations and furnishing needed supplies of gas" (I R. 5307).

The reasoning of this order was not merely an *ad hoc* determination, but indeed represented the Commission's consistent application of a well-considered policy in the granting of temporary certificates, *Federal Power Commission* v. *H. L. Hunt, et al.*, 376 U.S. 515 (1964); *Wisconsin* v. *Federal Power Commission*, 373 U.S. 294, 313 (1963);

American Liberty Oil Company v. *Federal Power Commission,* 301, F. 2d 15, 18-19 (5th Cir. 1962); *Area Rate Proceeding, et al.,* Docket Nos. AR61-2, *et al.,* 29 FPC 223 (1963).

It is thus clear that the Commission's orders granting these temporary certificates, subject only to prospective modification upon permanent certification, was a conscious and advertent application of its own formal policies, see *American Trucking Associations* v. *Frisco Transportation Company,* 358 U.S. 133, 146 (1958); *The Upjohn Company* v. *Pennsylvania Railroad Company,* 381 F.2d 4 (6th Cir. 1967).[41]

B. The Imposition Of Refund Liabilities Upon Sales Made In Reliance Upon Valid Temporary Certificate Orders Which Did Not Contain Refund Conditions Is Unlawful

The Commission's authority to attach conditions to the issuance of certificates of public convenience and necessity is found in Section 7(e), 15 U.S.C. §717f(e), which provides, in pertinent part, that:

> "* * * The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require * * *"

It is well settled that in appropriate circumstances the Commission can, in light of this statutory provision, pro-

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[41] The Court of Appeals for the Second Circuit (opinion by Friendly, J.) has held that an administrative "decision branding as 'unfair' conduct stamped 'fair' at the time a party acted, raises judicial hackles" and that "the hackles bristle still more when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known, or might even have been taken in express reliance on the standard previously established," *N.L.R.B.* v. *Majestic Weaving Co.,* 355 F.2d 854, 860 (2d Cir. 1966).

more probative evidence such as permanent certificates in its determination of in-line prices."

The result reached by the Commission was fully supported by the record and consumer protection objectives of the Natural Gas Act.

II. THE COMMISSION ERRED BY IMPOSING REFUND LIABILITIES RETROACTIVELY UPON PRODUCERS' SALES MADE PURSUANT TO AND IN RELIANCE UPON VALID TEMPORARY CERTIFICATE ORDERS WHICH MADE NO PROVISION FOR REFUNDS[31a]

The refund question raised by the petitions in Nos. 60-62, 80 and 97, concerns the rights conferred upon Producers by the temporary certificates of public convenience and necessity granted to them by the Commission pursuant to Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c).[32] Essentially, the Commission and Distributors contend that a temporary certificate order merely authorizes the sale of natural gas proposed by the applicant, but does not establish the terms and conditions of that sale during the period of temporary certification. The court below has held, however, that the temporary certificates at issue here authorized the collection of firm, nonrefundable prices and concluded, therefore, that the Commission lacked the power to impose refund liabilities retroactively upon these consummated sales under the guise of a refund condition attached to the permanent certificates.

On the basis of individual applications filed in accordance with Section 157.28(c) of the Commission's Regulations

[31a] This section of the brief is only applicable to those Respondents who were issued such temporary certificates.

[32] Section 7(c) provides, in pertinent part:

> "* * * That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate * * *" [52 Stat. 824, as amended, 56 Stat. 83, 15 U.S.C. 717f(c)].

under unconditioned temporary certificates which creates the refund question in this case. It is, therefore, critical to a proper resolution of this issue that consideration be given to the circumstances in which the temporary certificates governing those sales were issued and accepted authorizing the collection of proposed initial prices if no higher than the applicable *Policy Statement* price established by the Commission.

A. The Temporary Certificates Which The Commission Issued Were Individually And Maturely Considered And Were, In Fact, Implementations Of Its *Statement of General Policy No. 61-1*

The Court in 1959 in *CATCO*[36] admonished the Commission to give careful scrutiny to the initial price proposals of producers under Section 7 of the Natural Gas Act. The Court there suggested that if initial price proposals were not in the public interest, the Commission should impose appropriate conditions at the time of initial certification. Following *CATCO*, the Commission implemented the Court's directive by attaching various conditions to the certificate authorizations granted to producers. In the area of temporary certification, this policy was carried out by requiring a reduction in the initial price proposed or by imposing refund conditions.[37] In some cases, the Commission imposed both of these conditions in its temporary certificate orders in light of the circumstances of the particular initial price proposal before it. Whatever the condition imposed, it was based upon the Commission's recognition of the ne-

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[36] *Atlantic Refining Company* v. *Public Service Commission of New York*, 360 U.S. 378, 391 (1959).

[37] The Commission also used its conditioning power at the time of temporary certification to prohibit the filing of price increases in excess of the applicable *Policy Statement* level. The Court upheld a condition of this type in *Federal Power Commission* v. *H. L. Hunt*, 376 U.S. 515 (1964).

cessity to protect all segments of the public interest during the period of temporary certification.

Confronted with the responsibility of apprising the natural gas industry of its regulatory standards for producers, the Commission in 1960 issued its *Statement of General Policy No. 61-1* which established rate standards in various well-known producing areas of the United States (24 FPC 818). These standards included an initial price level for the particular area which was to govern the Commission in passing upon initial prices under new contracts executed after the *Policy Statement*. The Commission there stated:

> "* * * By this statement and the appended area price schedules we will set standards for initial and increased rate filings by producers for the sale of natural gas into interstate commerce. These standards will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended" (24 FPC 818).

It further stated that the acceptable initial rates for certification, as contained in the *Policy Statement,* were expressly based upon all of the relevant facts acquired by it as the result of six arduous years of producer regulation (24 FPC at 819).

The intent of the *Policy Statement* is unequivocally clear. It was designed to bring certainty to the area of producer regulation in a manner fair to all segments of the natural gas industry. It made clear that the Commission would not authorize new sales by producers unless their initial price proposals conformed to the applicable *Policy Statement* level. At the same time, it gave recognition to basic economic reality, *i.e.,* that the financial stability of the

spectively reduce an initial contract price as a condition to permanent certification, *Atlantic Refining Co.* v. *Public Service Commission,* 360 U.S. 378 (1959), *Texaco Inc.* v. *Federal Power Commission,* 290 F. 2d 149 (5th Cir. 1961). The Commission is similarly empowered to attach appropriate conditions to its grant of temporary certificates, *Federal Power Commission* v. *H. L. Hunt, et al.,* 376 U.S. 515 (1964); *American Liberty Oil Company* v. *Federal Power Commission,* 301 F. 2d 15 (5th Cir. 1962); *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission,* 270 F. 2d 404 (10th Cir. 1959).

However, the Commission's power to attach conditions to its certificate orders is not unlimited. In *Sunray Mid-Continent Oil Company* v. *Federal Power Commission, supra,* the Commission issued a temporary certificate which would have required the producer applicant to dedicate and sell his natural gas subject to indefinite refund liabilities, the extent of which was contingent upon the permanently certificated price. The reviewing court viewed this refund condition as requiring the producer "to speculate as to what the ultimate temporary rate may be" while dedicating his gas to public service (270 F. 2d at 409). Consequently, the court held that such a condition, purporting to hold in abeyance future conditions of unknown extent, was improper because it deprived the certificate holder of his right to know the conditions under which he was dedicating his gas to interstate commerce.

Until the issuance of its permanent certificate order in this case, the Commission had made clear that it relied upon the *Sunray Mid-Continent* decision as establishing the proper limits of its conditioning power. This was reaffirmed by the Commission's order of February 5, 1963 herein, when it refused to impose indefinite refund conditions upon the temporary certificates which it had previously issued to

Producers. In that same order, the Commission also observed that its refusal to impose refund conditions upon these certificates authorizing prices at or below its *Policy Statement* price created a salutary stability for all concerned since the firm price which it had authorized effected a proper balance between the interests of producers and consumers alike.

To assure the maintenance of prices temporarily certificated in keeping with the applicable *Policy Statement* level, the Commission has also found it advisable to impose certificate conditions which preclude the filing of contractually-authorized price increases above the *Policy Statement* level during the period of initial certification. The Commission has justified a condition of this type as necessary to the maintenance of a price which it has found to be consonant with the interests of producers and consumers alike. The propriety of just such a condition in a temporary certificate order has been upheld by the Court in its recent decision in *Federal Power Commission* v. *H. L. Hunt, supra.* The Court there recognized that the Commission possesses a broad power to condition temporary certificates at their issuance. At the same time, however, the clear implication in *Hunt* is that the conditioning power should be properly exercised in a manner fair to all concerned, including the certificate holder. Thus, the Court held that:

> "* * * the Commission must have the authority to condition a temporary certificate so as to avoid irreparable injury to affected parties. This condition, once imposed, continues only during the pendency of the producer's application for a permanent certificate. In view of the ex parte nature of the proceeding, *it appears only fair to all concerned that the condition upon which the rate was temporarily certified be continued unchanged until the permanent certificate is issued*" 376 U.S. at 523).

In the case-at-bar, the authorized initial prices ranged from 16 and 18 cents per Mcf. In the one instance where a Producer proposed a price in excess of the *Policy Statement* rate, the Commission fixed by condition the temporary certificate rate at the 18-cent level (I R. 4346-47). In granting the remaining temporary certificates, however, the Commission determined that it was not necessary to exercise its price conditioning power since the proposed prices were either less than or in conformity with the *Policy Statement*.[42] Contrary to the holding in *Hunt*, however, the Commission is here asking to be endowed with a power designed to modify retroactively the terms upon which it authorized sales of natural gas in interstate commerce. Thus it contends that, despite its plenary power to condition temporary certificates at issuance, it should also be authorized to exercise this plenary power with retroactive effect at a point in time long after the certificate holders have dedicated their gas to the interstate market in reliance upon the temporary certificates as issued in compliance with the Commission's regulations and its established policy.

Finally, the unreasonableness of a retroactively-imposed condition nullifying the terms and conditions of the Commission's temporary certificate orders in this case is high-

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[42] In *American Liberty Oil Company* v. *Federal Power Commission*, *supra*, the Commission's attachment of a price condition to a temporary certificate reducing the proposed price to the applicable *Policy Statement* level was judicially affirmed. In defending the reasonableness of such condition, the Commission pointed out to the reviewing court that it was thereby fulfilling its obligation to give a most careful scrutiny and responsible reaction to initial price proposals of producers under Section 7 of the Natural Gas Act, citing *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 391 (1959) [Brief of Federal Power Commission (p. 3), dated July 10, 1961, in *American Liberty Oil Company* v. *Federal Power Commission*, No. 18,827 (5th Cir.)].

lighted by the Commission's order of February 5, 1963. That order confirmed Producers' rights to a firm, nonrefundable price until modified prospectively upon permanent certification. To modify retroactively valid temporary certificate orders would, in the Commission's own words, "so denature the value of a Commission authorization as to place any reliance upon our actions in this area in serious jeopardy" (I R. 5307; 29 FPC at 220).[43] In view of the foregoing, the Court should hold that in these circumstances the Commission lacks the power to modify retroactively valid temporary cerificate orders.

C. Attempts To Read Refund Conditions, Express Or Implied Into The Temporary Certificates Are Contrary To Fact And Erroneous As A Matter of Law

The Commission and Distributors erroneously attempt to read a refund liability into the temporary certificates which were issued. First, they argue that certain language contained in the temporary certificates constitutes a condition which placed Producers on notice that refunds might ultimately be ordered. Second, they argue that the Commission possesses an inherent power to modify retroactively

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[43] See FPC Chairman Swidler's address to the 1961 Annual Meeting of the American Petroleum Institute. In explanation of the effect of the Commission's policy in granting temporary certificates authorizing producer sales at initial prices at or below the *Policy Statement* price levels, he stated:

> "* * * It is our policy to authorize initial sales on a firm basis at these prices, confident that they will be in the public interest and that refund conditions are not required * * *. Producers now know that all of the new initial price is theirs to keep * * *."

Recognizing this as one of many Commission assurances upon which producers relied in these circumstances, the court cited Chairman Swidler's address in *Pan American Petroleum Corp. v. Federal Power Commission,* 376 F.2d 161, 171 (10th Cir. 1967).

the terms of these temporary certificate orders. Both of these contentions are patently wrong.

(1) The temporary certificates contained no language which can reasonably be construed as a forewarning of possible refunds

Each of the temporary certificate orders which the Commission issued in this case, even those which included an express refund condition,[44] contained essentially the following language:

> "This constitutes all requisite temporary authorization to commence the sale of gas, but such authorization and acceptance of the rate schedule are without prejudice to such final disposition of the certificate application as the record may require and, furthermore, once service is commenced under this authorization it may not be discontinued without permission of the Commission issued pursuant to the provisions of the Natural Gas Act" (I R. 4147).

Indeed, every temporary certificate ever issued to an independent producer by the Commission has contained the foregoing boiler-plate language, or words to similar effect.

Before the court below, Commission counsel argued, in total disregard of the Commission's prior actions in this case and elsewhere, that the foregoing language was "more than adequate * * * to forewarn them [*i.e.*, Producers] of the possibility that refunds of excessive amounts collected

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[44] Typical of such refund condition is the following provision: "(1) The initial price for such service shall be 16 cents per Mcf at 14.65 psai, subject to Sun Oil Company refunding to South Texas Natural Gas Gathering Company from the date of first delivery any amounts collected plus interest at 7 percent per annum, in excess of 15.0 cents per Mcf which may be determined to be in excess of the price required by the public convenience and necessity in Docket No. CI62-276" (I R. 5312).

under the temporaries might ultimately be required by the Commission's final order."[45] This interpretation is wholly at odds with the meaning heretofore attributed to this language by the Commission itself.

At the hearing below, Distributors contended that the above-quoted language constituted an indefinite refund condition (I R. 66-67, 76). The Commission, however, made unmistakably clear, by its order of February 5, 1963 herein, that the foregoing language does not amount to a refund condition or a forewarning to the certificate holder that refunds my be imposed. Thus, despite the "without prejudice" language in each of the temporary certificates, the Commission held that they had been

> "* * * granted *without condition as to refund to a price below that at which the sale would be initiated.* The initial price would, however, continue to be collected until a *prospective* price could be determined after hearing upon the applications. Sales of gas were commenced by each of the producers pursuant to and in reliance upon the temporary authority" (I R. 5305; 29 FPC at 219).

Moreover, eight temporary certificates did contain explicit refund conditions as well as the routine language, quoted above. It is only reasonable to conclude, as did the court below, that if the Commission had intended the "without prejudice" language as a refund condition, it would not have been necessary to include also a specific refund condition in those temporary certificates.[46]

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[45] Brief of the Commission (p 27), dated March 14, 1966, in *Sunray DX Oil Company, et al.* v. *Federal Power Commission* (Nos. 7781, *et al.*, 10th Cir.).

[46] The court below took specific note of the temporary certificate issued to Sun Oil Company in FPC Docket No. CI62-276 (I R. 5312-13). This certificate order contained a refund condition as well as the "without prejudice" language. As to it, the court below correctly observed:

The Commission has also made clear elsewhere that it did not intend to impose refund liabilities upon sales made pursuant to temporary certificate orders containing this routine language.[47] As early as 1955, the Commission issued a permanent certificate to an independent producer authorizing a sale at 10 cents, after previously granting temporary certification of that sale at 12 cents. Although the temporary certificate order there contained the routine "without prejudice" language, quoted above, the Commission did not impose refund liabilities upon the collections made pursuant to the temporary certificate, *Cities Service Gas Company, et al.*, 14 FPC 134 (1955), *aff'd sub nom, Signal Oil and Gas Company* v. *Federal Power Commission*, 238 F. 2d 771, 773 (3rd Cir. 1956), *cert. den.*, 353 U.S. 293. Upon review, the Third Circuit noted that although the Commission could attach a prospective condition at the time of permanent certification, it could not retroactively reduce the rate collected under a temporary certificate containing the "without prejudice" language.

"* * * It contained a definite refund obligation covering collections at a rate above 15 cents per Mcf and the provision that: 'This temporary certificate and the acceptance of the above rate schedule are without prejudice to such final disposition of the application for certificate as the record may require.' The inclusion of this routine language could not mean that the explicitly floored refund obligation became floorless." *Sunray DX Oil Company* v. *Federal Power Commission*, 370 F.2d 181, 194, fn. 48 (10th Cir. 1966) [I R. 6740].

[47] Notably in the record in the related consolidated cases (Nos. 111, 143), the Commission expressly made clear that no refund liability is implied when a producer dedicates his gas under an unconditioned temporary certificate which contains the standard "without prejudice" language (III R. 357-59). Thus, in granting a temporary certificate to Skelly Oil Company at an initial price level below the applicable *Policy Statement* level, the Commission stated:

"* * * In issuing temporary authorizations to these producers, we will permit them to render service under their rate schedules without any conditions relating to initial prices where such prices are at or lower than those price levels set forth in our Policy Statement 61-1, as amended * * *" [III R. 66; 26 FPC 677, 683 (1961)].

In a later producer certificate case, the Commission in 1963 expressly refused to treat the routine "without prejudice" language as a refund condition, when contained in a temporary certificate order, *Placid Oil Company, et al.*, 30 FPC 283, 293 fn. 24 (1963); on rehearing, 30 FPC 682, 685 (1963).[48] In denying Distributors' attempts to have a retroactive refund obligation imposed in the latter case, the Commission found:

> "* * * Our refusal to order the refund was based upon the fact that the temporary authorization which had been granted Superior on October 22, 1958, did not contain a refund condition. Thus, although Superior [*i.e.*, the certificate holder] was informed that once service was commenced under the temporary authorization it could not be discontinued without permission of the Commission, there was nothing to alert it to the possibility that a refund might be required thereunder. For this reason we believe it would be inequitable to now require Superior to make the refund * * *" (30 FPC at 685).

It is also significant that virtually identical "without prejudice" language is employed by the Commission in its orders granting permanent certificates, in its orders approving rate settlements,[49] and in its orders accepting rate

[48] In that case, the Commission's power to compel refunds of amounts collected under judicially invalidated permanent certificates was upheld by the Court in *United Gas Improvement Co., et al.* v. *Callery Properties, Inc.*, 382 U.S. 223 (1965). However, the Commission's order refusing to impose refunds upon this temporary certificate containing the "without prejudice" language was not challenged there.

[49] *E.g., Humble Oil & Refining Company*, 32 FPC 49, 57 (1964); *Tidewater Oil Company*, 27 FPC 1267, 1271 (1962); *Gulf Oil Corporation*, 29 FPC 837, 841 (1963); *Sun Oil Company*, 32 FPC 894, 900 (1964); *Sunray DX Oil Company*, 33 FPC 129, 133 (1965). The only meaning which can be lawfully attributed to the "without prejudice" language in Commission orders approving rate settlements is that such approval does not bar prospective modification of the approved rates in appropriate circumstances.

increase filings without suspension where it is indisputable that the Commission cannot lawfully impose refund liabilities at a later time. In the case-at-bar, for example, the Commission's order granting permanent certificates was issued "without prejudice to any findings or order which have been or may hereafter be made by the Commission in any proceeding now pending or hereafter instituted * * *" (I R. 5796). Such language cannot and does not provide a basis for retroactive modification of valid permanent certificate orders, *United States* v. *Seatrain Lines, Inc.*, 329 U.S. 424, 433 (1947); see *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223, 229 (1965).

Similarly, in accepting rate increases under Section 4 of the Act without suspension, the Commission's orders always provide:

> "This acceptance for filing does not constitute authorization under Section 7 of the Natural Gas Act; nor shall it be construed as constituting approval of any rate or provisions contained in the rate filing; nor shall such acceptance be deemed as recognition of any claimed contractual right or obligation associated therewith; and such acceptance is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against your company."

This language is taken from the Commission's unreported order accepting Continental Oil Company's rate increase involved in the litigation leading to the Court's recent decision in *United Gas Pipe Line Company* v. *Federal Power Commission*, 385 U.S. 83 (1966). There, the Court noted that the pipeline purchaser, United Gas Pipe Line Company, had unsuccessfully sought rehearing of the Commission's order approving the rate increase but had not

sought judicial review of the Commission's order denying rehearing (385 U.S. at 85). Certainly, the Commission could not validly argue that the routine language contained in the order accepting Continental's rate increase would empower it at a later time to impose refund liabilities upon the monies collected under the increased rate accepted for filing. Yet, this is exactly what the Commission's present interpretation of the virtually identical language in its temporary certificate orders now suggests.

In light of the foregoing, it is readily apparent that the routine "without prejudice" language in the temporary certificate orders of the Commission, including those herein, was not intended by the Commission to constitute a refund condition or notice to the certificate holder that refund liabilities might ultimately be imposed. We respectfully submit that the Commission's present interpretation of this routine language is nothing more than a *post hoc* rationalization designed to justify a retroactive application of a change in Commission policy.

The true meaning of the above-quoted "without prejudice" language in its temporary certificate orders was correctly interpreted by the court below when it found as follows:

> "In our opinion these provisions mean that the Commission is not binding itself, by the issuance of a temporary certificate, to issue an identical permanent certificate of prospective effect after a hearing.[48] [Footnote omitted.] In its denial of the distributors' motion for refund conditions the Commission gave no recognition or effect to such provisions. We believe that the Commission intended the routine, boiler-plate language to have a purpose entirely different from that of an express refund condition" (I R. 6740-41; 370 F. 2d at 194).

The above interpretation by the court below of the "without prejudice" language in the temporary certificates at issue is not only correct on the basis of the record in this case, but is the only logical interpretation in light of the Commission's use of similar language in the other situations, noted above, where such language can only be given prospective effect as a matter of law.

(2) The Commission's regulations governing the issuance of temporary certificates do not provide for refund conditions in the absence of an express condition to that effect

The temporary certificates here involved were issued pursuant to Section 157.28 of the Commission's Regulations Under the Natural Gas Act. These Regulations have never contained any provisions forewarning a producer selling his gas under an unconditioned temporary certificate that he might later be required to refund monies collected under the filed rate schedule made effective by the temporary certificate. As the Tenth Circuit held in a 1959 decision:[50]

> "* * * Where conditions are imposed by the Commission the applicant has the free choice to accept or reject; to dedicate his property to public service or to refuse so to do; to submit to the jurisdiction of the Commission or to remain beyond the bounds of interstate commerce. This choice cannot be exercised by the applicant if the Commission says, in effect: 'Sell your gas; collect your proposed initial price; we will later tell you if you can keep your collections; if we decide you cannot, you must assure refund by a bond' " (270 F. 2d 404, 409).

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[50] *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 270 F.2d 404 (10th Cir. 1959).

Yet, according to the Commission's *present* argument, it is irrelevant that the Producers initiated their sales of gas under unconditioned temporary certificates issued under such regulations, which specifically indicated that the rate schedule on file would be the sole determinant of price. Nonetheless, the Commission *now* claims that the payments received for gas sold under these temporary certificates were provisional only and that the Commission can now require refunds.

The Commission's action in promulgating Section 157.28 of its Regulations Under the Natural Gas Act belies this contention. This regulation was issued only after public notice (21 F.R. 4833) and careful consideration of comments submitted by all segments of the natural gas industry (Order No. 193, 16 FPC 497). With particular reference to the problem here involved, the Commission noted:

> "Suggestion has been made that the requirement that there be on file an *effective* rate schedule covering the proposed service filed in accordance with Section 154.91 through 154.102 of the Regulations be deleted. We do not deem it advisable to eliminate this requirement, * * *
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> * * *
>
> "No sales or transportation subject to the Natural Gas Act may be made without rate schedules therefor being on file with the Commission. This requirement applies whether the sales or transportation are on a temporary emergency or permanent basis. * * * Acceptance of a rate schedule for temporary or emergency service is no assurance that it will be accepted by the Commission for permanent service, or that rate conditions may not be included in the certificate authorization" (16 FPC 497, 498).

Thus, by this language, the Commission made clear (1) that no sale under a temporary certificate could be made in

the absence of a filed rate schedule effective for the period of temporary certification, and (2) the Commission's acceptance of the rate schedule for temporary service would not bind the Commission to accept it for permanent service. Accordingly, when the temporary certificates in the case-at-bar were issued, the rate schedules designated and accepted for filing contained the unconditionally effective rate for the period of temporary certification. As a consequence, such rates could only be modified *prospectively* upon permanent certification. Plainly, therefore, any attempt to change the filed rate effective for such temporary service by means of a condition in the permanent certificate and the requirement of a refund in respect thereof, constitutes retroactive rate making and an effort unlawfully to extract reparations. See, *e.g.*, *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944); *Montana Dakota-Utilities Co.* v. *Northwestern Public Service Co.*, 340 U.S. 246, 251 (1951).

(3) The Court's *Callery* decision does not authorize the retroactive modification of the temporary certificates

The Commission and Distributors also contend that the Commission can modify retroactively lawful temporary certificate orders which have not been set aside on judicial review. This contention is essentially based upon their misreading of the Court's decision in *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223 (1965).

The *Callery* case involved the question of the Commission's power to redetermine *ab initio* the terms and conditions of producer sales made pursuant to permanent certificates which had never become final and had been later set aside. In that case the Court was faced with the contention that the Commission lacked the power to modify retroactively the prices collected pursuant to the judicially in-

validated certificates. In support of this contention, the certificate holders argued that the ordering of refunds in those circumstances constituted an award of reparations. The Court agreed that the Commission lacks the power to make reparation orders, *Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 618 (1944). The Court, however, held that the Commission is empowered to impose refund liabilities upon collections made pursuant to an invalidated certificate order since "an agency, like a court, can undo what is wrongfully done by virtue of its order" (382 U.S. at 229).

Unlike the situation in *Callery,* Producers here have made their sales pursuant to lawfully issued temporary certificate orders which have never been set aside. Until March 23, 1964, the Commission had never suggested in this case, or anywhere else for that matter, that the amounts collected in reliance upon those lawful orders were subject to possible refund liabilities. Indeed, the Commission affirmatively made clear just the contrary. The Commission recognized unequivocally, in its order of February 5, 1963, that the prices, authorized by its temporary certificate orders, were firm prices upon which the certificate holders could rely. With equal force, it denied Distributors' request that prospective refund conditions be imposed. From the point of view of Distributors, this order was a definitive order subject to review under Section 19(b) of the Natural Gas Act. However, the Distributors did nothing more.

It is well-established that the Commission's temporary certificate orders are judicially reviewable, *Federal Power Commission* v. *H. L. Hunt,* 376 U.S. 515 (1964); *Texaco Inc.* v. *Federal Power Commission,* 290 F. 2d 149, 156 (5th Cir. 1961). In *Pennsylvania Railroad Company* v. *United States,* 363 U.S. 202, 205 (1960), the Court held that an administrative order which "determines a 'right or obligation' so that 'legal consequences' will flow from it is reviewable." See

also: *Trans World Airlines, Inc.* v. *Civil Aeronautics Board*, 339 F. 2d 56, 63 (2d Cir. 1964), *cert. denied sub nom. Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 382 U.S. 842; *Cities Service Gas Company* v. *Federal Power Commission*, 255 F. 2d 860, 863 (10th Cir. 1958), *cert. denied sub nom. Magnolia Petroleum Co.* v. *Cities Service Gas Co.*, 358 U.S. 837; *Isbrandtsen Co.* v. *United States*, 211 F. 2d 51 (D.C. Cir. 1954), *cert. denied sub nom. Japan-Atlantic & Gulf Conf.* v. *United States*, 347 U.S. 990. By its order of February 5, 1963, the Commission held that the prices being collected by Respondents under their temporary certificates were firm prices subject only to prospective modification at the time of permanent certification. Notwithstanding the definitive language of the February 5th order, the distribution company interests took no appeal from it, and the time for seeking review thereof under Section 19(b) of the Natural Gas Act has long since expired. As a consequence, this order became binding upon them and the Commission itself. *Pan American Petroleum Corp.* v. *Federal Power Commission*, 322 F. 2d 999, 1004 (D.C. Cir. 1963). In *Pan American*, the court observed that an administrative agency retains jurisdiction to reconsider and modify its order only until the time for judicial review has expired.

This case concerns not only a repudiation by the Commission of its own orders, which were binding upon all. It also concerns a repudiation by the Commission of its long-held position, as represented to the Court in *Federal Power Commission* v. *H. L. Hunt*, *supra*, that the *status quo* established by the grant of temporary certificates at prices conforming to the Commission's *Policy Statement* level should be maintained even if it be necessary to prohibit contractually-authorized price increases above that level during the period of temporary certification. If the Commission were permitted to nullify retroactively its own

orders, upon which Producers were led to rely by the Commission itself, it would be tantamount to saying that the official word of the Federal Government is little more than a snare and delusion, unworthy of reliance. Traditionally, courts have refused to give their sanction to such behavior by administrative agencies, *Chapman* v. *El Paso Natural Gas Co.*, 204 F. 2d 46 (D. C. Cir. 1953); see *Safarik* v. *Udall*, 304 F. 2d 944, 949-50 (D.C. Cir. 1962), *cert denied sub nom, Hansen* v. *Udall*, 371 U.S. 901. In *Chapman*, the court held that the Secretary of the Interior could not alter the terms of a prior authorization granting pipeline right-of-way over Federal lands. In his concurrence, Judge Prettyman stated:

> "* * * the official word of a Government officer acting within the scope of his authority should be the maximum in reliability — binding and not changeable at his wish" (204 F. 2d at 54).

In the circumstances presented by the case-at-bar, the Commission's imposition of retroactive refunds upon sales made by Producers under valid orders of the Commission, which did not contain refund conditions, constitutes the exercise of the power of reparations which the Commission does not possess, *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 470 (1959); *Montana Dakota-Utilities Co.* v. *Northwestern Public Service Co.*, 340 U.S. 246, 251, 254 (1951); *Signal Oil and Gas Co.* v. *Federal Power Commission*, 238 F. 2d 771, 773 (3rd Cir. 1956), *cert. denied*, 353 U.S. 923.

Conclusion

For the foregoing reasons, the judgments of the Court of Appeals for the Tenth Circuit should be affirmed.

Respectfully submitted,

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APPENDIX A

1. The pertinent provisions of the Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. 717-717w, are as follows:

* * * * *

SEC. 7(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts, or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a

temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

* * * * *

Sec. 7(e) Except in the case governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

2. The Commission's Regulations Under the Natural Gas Act, 18 C.F.R., Subchapter E, as amended, provide in pertinent part:

Sec. 157.28. Temporary authorizations.

Upon the filing of an application for a certificate of public convenience and necessity under §§ 157.23 to 157.27, there also having been filed a rate schedule under §§ 154.91 through 154.102 of this chapter, an in-

dependent producer, in the event of an emergency that does not involve immediate danger to life or property, may initiate the sale or transportation of natural gas in interstate commerce and continue such sale or transportation pending final Commission action under sections 4 and 7 of the Natural Gas Act and without prejudice to such rate or other condition as may be attached to the issuance of the certificate: *Provided, however,* That this temporary authorization is applicable and available only subject to the following:

(a) It does not apply to termination of any sale or transportation or with respect to service proposed to commence more than 90 days from the date on which the temporary authorization is issued by the Commission unless otherwise ordered for good cause shown. [Cum. Supp. 1963.]

(b) It shall not apply unless such facilities as may be necessary to enable the purchaser of the gas or the person by whom the transportation is to be performed to accept delivery of such gas from the independent producer have been authorized by the Commission or are exempt from the need of such authorization by virtue of the provisions of § 2.55(d) of this chapter.

(c) As part of its application hereunder, or separately, the applicant independent producer must file or have on file (1) a statement of intention to invoke this section, setting forth the facts constituting the emergency requiring such action, which emergency may include, inter alia, drainage, threatened loss of lease, flaring, economic hardship resulting from payment of shut-in royalties, or similar situations; (2) a statement identifying the contract tendered as the rate schedule intended to be effective for the sale or transportation under this temporary authorization; and (3) a statement describing, generally, the facilities necessary to enable the purchaser to take delivery of the gas proposed to be sold or transported.

3. The Commission's *Statement of General Policy No. 61-1*, 18 C.F.R. §2.56, 24 FPC 818, is as follows:

UNITED STATES OF AMERICA, FEDERAL POWER COMMISSION

STATEMENT OF GENERAL POLICY NO. 61-1

ESTABLISHMENT OF PRICE STANDARDS TO BE APPLIED IN DETERMINING THE ACCEPTABILITY OF INITIAL PRICE PROPOSALS AND INCREASED RATE FILINGS BY INDEPENDENT PRODUCERS OF NATURAL GAS

(Issued September 28, 1960)*

Before Commissioners: JEROME K. KUYKENDALL, *Chairman;* FREDERICK STUECK and ARTHUR KLINE.

This statement establishing rate standards for independent producers of natural gas is issued on our own motion and is based on our experience gained after six years of regulation of independent producers under the Natural Gas Act. By this statement and the appended area price schedules we will set standards for initial and increased rate filings by producers for the sale of natural gas into interstate commerce. These standards will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended.

Since the Supreme Court's 1954 decision in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 674, holding that under the Natural Gas Act the Commission has jurisdiction over the interstate transportation and interstate

* Published in Federal Register, October 5, 1960 (25 F.R. 9578) and corrected, April 11, 1961 (26 F.R. 3066). Codified as 18 C.F.R. 2.56. Secretary's rejection of application for rehearing affirmed by order issued November 25, 1960. Amended by orders issued October 25, 1960, and December 20, 1960, 24 FPC 902, and 1107, respectively, and March 29, 1961, 25 FPC 595.

sale for resale of natural gas by independent producers, and that such producers are "natural-gas companies" under the Act, the Commission's regulatory task has increased enormously in size and difficulty. In contrast to the regulation of less than 200 pipeline companies prior to the *Phillips* case, under this decision Commission regulation extends to several thousand independent producers of natural gas. Although this producer segment of the natural gas industry differs from the pipeline transmission portion in fundamental particulars, its multiplicity of sales and services are now required to be covered by many thousands of rate and certificate filings under the Act. . .

This ever-growing volume of additional rate and certificate filings has placed an increasing burden not only on this Commission and other regulatory commissions, but on all those — consumers, producers, pipeline companies, and distributing companies as well — whose interests we must consider in administering the Act. It is essential, particularly in the interest of the consumer for whose protection the statute was enacted, that means be found for making the most effective use possible of the Commission's limited facilities in discharging the new and additional duties called for by the regulation of producers of natural gas. In our opinion, the price standards established by this statement will aid in effectively applying the provisions of the Act to independent producers on a simple, clear and administratively feasible basis, and in a manner fair to all whose interests are affected by Commission regulation. Our many reasons for establishing these maximum acceptable rates as opposed to establishing rates based on a full cost-rate, base hearing for every rate filing made by producers are set forth at considerable length in our opinion No. 338, *Phillips Petroleum Co.,* Docket No. G-1148, et al., pp. 542 thru 548, *ante,* issued on this date.

Some further explanation is required of certain aspects of these area rate levels. The geographical areas which we have used are convenient and well known. They are not necessarily in complete accord with geographical and economic factors which may be relevant to the establishment of pricing areas. As experience and changing factors may indicate, we will change or alter these areas from time to time in order to eliminate such inequities as may appear to exist because of our use of geographical boundaries.

In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas. Of necessity, we have not set forth the adjustments to these prices which must be made to take into account every possible provision of every contract which may affect the actual price, such as Btu adjustments, conditions of delivery, etc. The relevance of such adjustments to the basic contract price and the appropriate established price standard must be considered as each filing is made. As it becomes apparent that certain adjustments have general applicability in a specific area, the area price standard will be revised and set forth in greater detail with regard to the exact sale conditions to which the rate applies. We should, however, make it clear that these present price standards apply to pipeline quality gas as that term is generally understood in each area and, except for the Louisiana prices, are inclusive of all taxes.

Two price standards are set for each area. Initial prices in new contracts are, and in many cases by virtue of economic factors, must be higher than the prices contained in old contracts. For this reason, we have found it advisable to adopt two schedules of prices, one pertaining to initial prices in new contracts and one pertaining to escalated prices in existing contracts. It is anticipated that these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas.

It will be noted that we have omitted listing an initial price level for sales from Southern Louisiana and Mississippi. The proper initial price level for these areas is currently the subject of two hearings pursuant to Supreme Court Decisions. *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378; *Public Service Commission* v. *F.P.C.*, 361 U.S. 195, F.P.C. Docket Nos. G-11024, *et al.*, and G-13143, *et al.*, respectively. Clearly, in light of these cases, it would not be proper at this time for us to announce an initial rate level for these areas prior to a final determination of these cases.

These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level. As with the areas, the prices will be adjusted from time to time as such facts as may come before us compel such adjustments. For the present, and in the absence of compelling evidence calling for other action by us, proposed initial sales of natural gas by independent producers which include rates higher than those indicated in the appendix attached to this statement shall be denied a certificate or certificated only upon the condition that lower rates be filed, and all

rate changes filed under existing contracts which call for a rate exceeding the indicated price level in the attached appendix to this statement shall be suspended.

Where a proposed price exceeds the indicated rate level and is therefore conditioned or suspended we will, in determining whether the higher price is justified, not necessarily consider only the financial requirements of the individual producer proposing the price but will consider all of the above elements relevant to the industry generally in the area concerned. Similar evidence will also be required from purchasers or their customers who object to any of the price levels or any specific price. Our determination will be in the nature of setting a price for the gas itself from any source questioned and not necessarily a price applicable solely to the party proposing some other price. In this connection we urge that all parties who have any interest in changing an area price join in such a proceeding leading to a determination of a proper revision, if any, in an area price or in the geographical area itself. As there will undoubtedly be numerous parties with an interest in such a proceeding full use should be made of prehearing procedures to reduce the factual issues and consolidate factual presentations to eliminate repetition and duplication of evidence. Because of the impossibility of giving detailed instructions for every proceeding, the precise course of each hearing and the admissibility and relevant weight of each type of evidence must be determined as hearings proceed and we expect to issue additional policy statements from time to time clarifying various aspects of these procedures and principles. The new area rate determinations resulting from such proceedings will represent final determinations of just rates for the areas involved as of the date of the decision and for prior periods.

Appendix A

(To Statement of General Policy No. 61-1)

Area price levels for natural gas sales by independent producers

[All rates at 14.65 Psia]

Area	Initial service rates per Mcf	Increased rates per Mcf
Texas:		
District No. 1	15 cents	14 cents.
District No. 2	18 cents	14 cents.
District No. 3	18 cents	14 cents.
District No. 4	18 cents	14 cents.
District No. 5	14 cents	14 cents.
District No. 6	15 cents	14 cents.
District No. 7-b	14 cents	11 cents.
District No. 7-c	16 cents	11 cents.
District No. 8	16 cents	11 cents.
District No. 9	14 cents	14 cents.
District No. 10	17 cents	11 cents.
Louisiana:		
Southern	Not determined	13.7 cents (14 cents at 15.025 psia).
Northern	16.6 cents (17 cents at 15.025 psia)	13.7 cents (14 cents at 15.025 psia).
Mississippi	Not determined	13.7 cents (14 cents at 15.025 psia).
Oklahoma:		
Panhandle area	17 cents	11 cents.
Other	15 cents	11 cents.
Carter-Knox	16.8 cents	11 cents.
Kansas	16 cents	11 cents.
New Mexico:		
Permian Basin	16 cents	11 cents.
San Juan Basin	12.7 cents (13 cents at 15.025 psia)	12.7 cents (13 cents at 15.025 psia).
Colorado	14.6 cents (15 cents at 15.025 psia)	12.7 cents (13 cents at 15.025 psia).
Wyoming	15 cents	12.7 cents (13 cents at 15.025 psia).
West Virginia	26.8 cents (28 cents at 15.325 psia)	23.9 cents (25 cents at 15.325 psia).

APPENDIX B

SUMMARY OF THE EVIDENCE JOINTLY SPONSORED BY THE PRODUCERS AND EXCLUDED BY THE COMMISSION

Producers in the administrative proceedings below attempted to present five witnesses and eight exhibits in order to support and justify their proposed sales of natural gas for resale in interstate commerce at the contract prices. This entire evidentiary presentation was excluded by the Commission but was submitted as an offer of proof.[1] The following is a summary of Producers' joint presentation:

(1) Frith C. Owens, a consulting geologist and petroleum engineer from Corpus Christi, Texas, with over twenty years of experience specializing in the exploration for oil and gas in the Texas Railroad Commission District No. 4 presented testimony and exhibits on the prospects for further gas exploration and development in the deep sedimentary horizons or formations underlying that area. (I R. 214-216)

After outlining the history of oil and gas exploration and development in District No. 4, (I R. 220-222) Mr. Owens demonstrated that most of the gas from the shallower formations had been found and developed in District No. 4 (I R. 226) but that there are deep sedimentary geological horizons or formations underlying the geographic area comprising that district which at this time are relatively unexplored. (I R. 217-219; 1161) Mr. Owens' analysis of the deeper exploration accomplished in District No. 4 up to the present time resulted in the conclusion that these deep formations (below 6,000 feet) were clearly in the gas province. (I R. 216, 219-220; 227-228, 1164) Mr. Owens specified

[1] This testimony is contained in the Joint Appendix and related exhibits filed in the court below, copies of which were filed in this Court concurrently with the Petition for Certiorari in No. 60.

the deep formations underlying District No. 4, to which those seeking to find new supplies of natural gas would be able to direct their search. (I R. 224-226) However, Mr. Owens concluded that a price incentive was necessary to encourage the finding and development of the deeper gas reserves located in this area, because such exploration and development requires more complex, and thus more expensive, activities to find and develop the reserves. (I R. 231) Paramount in these higher costs are the drilling costs which increase significantly with greater depth. (I R. 231-232)

Mr. Owens also concluded, after enumerating the activities necessary for exploration and development of new gas supplies, (I R. 230-232) that the greater risk in locating and bringing the market the deep supplies of gas required sufficient incentive "by adequate and firm gas prices. Without this incentive in my opinion, this exploratory effort cannot be accomplished." (I R. 233)

(2) Sherman H. Clark, a fuels economist with the Stanford Research Institute, Menlo Park, California, presented a study prepared under his direction by the Stanford Research Institute showing the estimated growth in demand for natural gas in each year during the period from 1960 through 1970. (I R. 236-240)

Exhibit No. 6 which tabulated and recorded the results of Mr. Clark's studies and projections, contained detailed data including graphs, charts and tables showing the past and projected demand of the various areas of the country for natural gas by end use. These end uses included residential, commercial, refinery, pipeline, other industrial steam-electric and carbon black.

On the basis of the Stanford Research Institute study, Mr. Clark concluded that the increase in demand for natural gas in the United States would increase by approximately 3.5% each year from 1960 through 1970. (I R. 1165-1264) The net domestic production required

to meet the demand for natural gas in 1960 was 13.3 trillion cubic feet. (I R. 249, 1165-1264) Mr. Clark estimated that net domestic production would have to increase to approximately 15.9 trillion cubic feet in 1965 and 18.9 trillion cubic feet by 1970 in order to meet the increased demand for natural gas. (I R. 249, 1165-1264)

(3) Radford L. Schantz, a consulting economist from Washington, D.C. presented testimony and Exhibit No. 7 directed to whether the contracts involved in this proceeding are required by the public convenience and necessity. (I R. 284) Mr. Schantz examined comprehensive economic data contained in Exhibit No. 7 and considered trends in the exploration and development of gas supplies, productivity of the exploratory and drilling effort, cost, prices, supply and demand for gas and the available markets for the gas produced in Texas Railroad Commission District No. 4. (I R. 285-286) Based on his analysis of these factors, Mr. Schantz concluded that supplies of natural gas had declined relative to net production and prospective demand, as estimated by Mr. Clark, so as to cause concern with respect to the adequacy of future supplies. (I R. 322) He also concluded that rising drilling and related costs in the Texas Gulf Coast Area (including Texas Railroad District No. 4), as well as a reduction in the contract prices for sales made from that area by the Federal Power Commission had definitely impaired incentives to find and develop the necessary supplies of natural gas. (I R. 323) With respect to future supplies of gas, Mr. Schantz observed that a serious time lag exists between the decision to explore and the discovery of new gas supplies. Consequently, the incentive to find these new future supplies must be given today, not when a shortage occurs. (I R. 323)

Mr. Schantz also testified that the rapid industrial growth in the Texas Gulf Coast Area has created an effective alternative market for new supplies of gas found in District No. 4 despite sales in 1960 and 1961

at 18¢ per Mcf covering approximately 38% of the gas produced in that district. (I R. 324)

Exhibit No. 7 (I R. 1265-1355) presented by Mr. Schantz contained, except for working papers, the data and materials on which Mr. Schantz based his conclusions and from which he gave his opinions, as well as a listing of all contracts filed with the Federal Power Commission for the sale of new supplies of gas produced in District No. 4 from 1960 through July, 1962.

Based on his analysis and these considerations, Mr. Schantz concluded that the initial contract prices proposed by producers, up to and including 18¢ per Mcf were required by the present and future public convenience and necessity. (I R. 322)

(4) R. H. Park, Assistant Division Manager, Gas Division, Texaco Inc., Houston, Texas, presented a study on the minimum financial requirements for finding and developing new supplies of natural gas if producers are to keep supplies in pace with increased demand. (I R. 341) Mr. Park analyzed the recent productivity of gas well drilling in the industry which in his study is the relationship between the gas reserves added and the expenditures which must be made by producers to add those reserves. (I R. 344-345) In Exhibit No. 8 (I R. 1356-1373), Mr. Park provides the Commission with an estimate of the minimum unit cost per Mcf of marketed production required to add new reserves of natural gas based on the industry's recent aggregate experience in the producing industry.

On the basis of his study, Mr. Park concluded that in order to meet the Producers' minimum financial requirements, it is necessary to have a nation-wide average price level for current resales of natural gas of approximately 23¢ per Mcf. (I R. 348, 1358-1359) Mr. Park reasoned that this nation-wide average price level is necessary in order to permit producers to recover their capital expenditures, their current operating expenses, royalty payments and production taxes. (I R. 348)

Mr. Park specifically related the use of the industry-wide financial requirements to the determination of an appropiate initial price for new sales of gas produced in Texas Railroad Commision District No. 4 and recommended that any price level for District No. 4 should not be less than 18¢ per Mcf. (I R. 379-381)

(5) Douglas L. Henry, an engineer for Gulf Oil Corporation, Houston, Texas, presented data on the average depth of wells producing gas upon which the Commission predicated the 15¢ per Mcf "in-line" price, as compared with the deeper average depth of Gulf wells producing the gas sold to Natural Gas Pipeline Company of America from the Escobas and Martinez Fields.[2] (I R. 451-455)

Mr. Henry also compared Gulf's costs to drill and complete its shallower wells (approximately 5,000 feet) in District No. 4 with its cost to drill and complete the deeper wells (over 12,000 feet) committed to its contract and concluded that the deeper wells were 379% more expensive. (I R. 455-456)

Utilizing industry data, Mr. Henry estimated the cost to drill and complete a well to the average depth of wells upon which the Commission predicated its 15¢ per Mcf "in-line" price in its *Skelly* decision and shows that this estimated cost was substantially less than the actual cost incurred by Gulf in drilling its deeper wells.

In addition, Mr. Henry testified that even at the contract price proposed, including all of the price escalations, the revenues generated by Gulf's sale would provide Gulf with barely a 9% return on its average investment after recovery of only the on-lease development and producing costs. (I R. 457)

[2] This portion of Mr. Henry's testimony concerning comparisons was admitted by the Examiner, but not considered by the Commission in reaching its decision.